

No. 11823

United States
Circuit Court of Appeals
For the Ninth Circuit

LEO M. HARVEY and LENA P. HARVEY,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of the Record

Upon Petitions to Review a Decision of the Tax Court
of the United States

FILED

AUG 5 - 1948

PAUL R. O'BRIEN,
CLERK

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES

For Taxpayer:

GEORGE T. ALTMAN.

For Comm'r.:

R. C. WHITLEY,

E. A. TONJES.

Docket No. 7116

LEO M. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1945

- Feb. 12—Petition received and filed. Taxpayer notified. Fee paid. 4 copies received 2/15/45.
- Feb. 15—Copy of petition served on General Counsel.
- Mar. 19—Answer filed by General Counsel.
- Mar. 19—Request for hearing in Los Angeles, California, filed by General Counsel.
- Mar. 23—Notice issued placing proceeding on Los Angeles, Calif., calendar. Service of answer and request made.
- Apr. 2—Motion for judgment on the pleadings, and to set same on Los Angeles calendar for hearing filed by taxpayer.
- Apr. 18—Hearing set on petitioner's motion 5/16/45.
- Apr. 18—Copy of motion and notice of hearing served on General Counsel.
- May 14—Notice of submission under Rule 30 with brief in support attached filed by taxpayer. 5/15/45 Copy served on General Counsel.

1945

May 16—Hearing had before Judge Murdock on petitioner's motion for judgment on the pleadings. Ordered C.A.V. Respondent's memorandum in opposition to motion filed at hearing.

May 17—Motion of April 2 for judgment on pleadings denied.

1946

Sept. 6—Motion for leave to amend petition embodying amendment filed by taxpayer.

Sept. 11—Hearings set Nov. 4, 1946, Los Angeles.

Sept. 11—Hearing set 10/9/46 on petitioner's motion.

Sept. 11—Copy of motion and notice of hearing served on General Counsel.

Sept. 18—Motion to transfer the motion to amend petition set for hearing 10/9/46, Washington, D. C., to the merit calendar of Nov. 4, 1946, Los Angeles, filed by taxpayer. 9/20/46 copy served.

Oct. 9—Hearing had before Judge Turner on petitioner's motion to amend petition granted.

Oct. 9—Order that petitioner's motion to amend petition filed 9/6/46 is granted, entered.

Nov. 4—Hearing had before Judge Hill on merits. Motion of counsel to consolidate dks. 7116 and 7117 granted. Oral motion of Petitioner to file amendment to petition granted. Motion of respondent to file answer to amendment to petition and answer

to petition as amended granted. Motion and amendment to petition, answer to amendment to petition and answer to petition as amended filed at hearing and served. Briefs due 12/23/46; replies due 1/22/47. [1*]

1946

Dec. 4—Transcript of hearing 11/4/46 filed.

Dec. 4—Transcript of hearing 11/8/46 filed.

Dec. 17—Brief filed by taxpayer.

Dec. 18—Motion for extension to Jan. 23, 1947, to file brief and to Feb. 22, 1947, to file both reply briefs filed by General Counsel. 12/19/46 Granted.

1947

Jan. 6—Supplement to brief filed by taxpayer. 1/16/47 Copy served.

Jan. 15—Brief filed by General Counsel.

Jan. 29—Reply brief filed by taxpayer. 1/29/47 Copy served.

Feb. 7—One page addition to reply brief filed by taxpayer. 2/7/47 copy served.

Feb. 12—Reply brief filed by General Counsel.

Mar. 24—Memorandum findings of fact and opinion rendered. Judge Hill. Decision will be entered under Rule 50. 3/24/47 copy served.

Apr. 28—Motion for extension to five days to file a motion for rehearing filed by taxpayer. Granted.

*Page numbering appearing at top of page of original certified Transcript of Record.

1947

Apr. 28—Motion for a rehearing filed by taxpayer.

Apr. 29—Order amending memorandum findings of fact and denying petitioner's motion for rehearing entered.

June 4—Respondent's computation for entry of decision filed.

June 6—Hearing set July 16, 1947, Washington, D. C., on Rule 50.

July 16—Hearing had before Judge Hill on settlement. No contest. Ordered Respondent's computation. Judge Hill for order.

July 17—Decision entered, Judge Hill, Div. 2.

July 22—Order amending decision, entered.

Oct. 17—Petition for review by U. S. Circuit Court of Appeals for the Ninth Circuit with assignments of error filed by taxpayer.

Oct. 17—Proof of service filed.

Nov. 24—Certified copy of an order from the Ninth Circuit for enlargement of 40 days to file transcript of record filed.

Nov. 24—Certified copy of an order from the Ninth Circuit directing the Clerk of the Tax Court to transmit to the Clerk of the Circuit Court the original petitioner's exhibit 1 and respondent's exhibits A through K 15 days prior to the hearing filed.

Nov. 25—Designation of record filed by taxpayer with proof of service thereon. [2]

Docket No. 7117

LENA P. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1945

- Feb. 12—Petition received and filed. Taxpayer notified. Fee paid. Copy received 2/15/45.
- Feb. 15—Copy of petition served on General Counsel.
- Mar. 19—Answer filed by General Counsel.
- Mar. 19—Request for hearing in Los Angeles, Calif., filed by General Counsel.
- Mar. 23—Notice issued placing proceeding on Los Angeles, Calif., calendar. Service of answer and request made.
- Apr. 2—Motion for judgment on the pleadings and to set same on Los Angeles, Calif., calendar for hearing filed by taxpayer.
- Apr. 18—Hearing set on petitioner's motion for 5/16/45.
- Apr. 18—Copy of motion and notice of hearing served on General Counsel.
- May 14—Notice of submission under Rule 30 with brief in support attached filed by taxpayer. 5/15/45 copy served on General Counsel.

1945

- May 16—Hearing had before Judge Murdock on petitioner's motion for judgment on the pleadings. Ordered C.A.V. Respondent's memorandum in opposition to motion filed at hearing.
- May 17—Motion of April 2, for judgment on pleadings denied.

1946

- Sept. 6—Motion for leave to amend petition embodying amendment filed by taxpayer.
- Sept. 11—Hearing set Nov. 4, 1946, Los Angeles.
- Sept. 11—Hearing set 10/9/46 on petitioner's motion.
- Sept. 11—Copy of motion and notice of hearing served on General Counsel.
- Sept. 18—Motion to transfer the motion to amend petition now set for 10/9/46, Washington, D. C., to the merit calendar of 11/4/46 at Los Angeles filed by taxpayer. 9/20/46 copy served.
- Oct. 9—Hearing had before Judge Turner on petitioner's motion to amend petition granted.
- Oct. 9—Order that petitioner's motion to amend petition filed 9/6/46 is granted, entered.
- Nov. 4—Hearing had before Judge Hill on merits. Motion of counsel to consolidate 7116 and 7117 granted. Motion of petitioner to file amendment to petition granted. Motion of respondent to file answer to amendment to petition and answer to pe-

tion as amended granted. Motion and amendment to petition, answer to amendment and answer to petition as amended filed at hearing, and served. Briefs due 12/23/46; replies due 1/22/47. [3]

1946

Dec. 17—Brief filed by taxpayer.

Dec. 18—Motion for extension to Jan. 23, 1947, to file brief and to 2/22/47 to file replies filed by General Counsel. 12/19/46 Granted.

1947

Jan. 6—Supplement to brief filed by taxpayer. 1/16/47 copy served.

Jan. 15—Brief filed by General Counsel.

Jan. 29—Reply brief filed by taxpayer. 1/29/47 copy served.

Feb. 7—One page addition to reply brief filed by taxpayer. 2/7/47 copy served.

Feb. 12—Reply brief filed by General Counsel.

Mar. 24—Memorandum findings of fact and opinion rendered. Judge Hill Decision will be entered under Rule 50. 2/24/47 copy served.

Apr. 28—Motion for extension of five days to file motion for rehearing filed by taxpayer. Granted.

Apr. 28—Motion for a rehearing filed by taxpayer. 4/29/47 Denied.

Apr. 29—Order amending memorandum findings of fact and denying petitioner's motion for rehearing, entered.

1947

- June 4—Respondent's computation for entry of decision filed.
- June 6—Hearing set July 16, 1947, Washington, D. C., on Rule 50.
- July 16—Hearing had before Judge Hill on settlement. No contest. Respondent's computation ordered to Judge Hill for order.
- July 17—Decision entered, Judge Hill, Div. 2.
- July 22—Order amending decision, entered.
- Oct. 17—Petition for review by U. S. Circuit Court of Appeals for the Ninth Circuit with assignments of error filed by taxpayer.
- Oct. 17—Proof of service filed.
- Nov. 24—Certified copy of an order from the Ninth Circuit for enlargement of 40 days to file transcript of record filed.
- Nov. 24—Certified copy of an order from the Ninth Circuit directing the Clerk of the Tax Court to transmit to the Clerk of the Circuit Court the original petitioner's exhibit 1 and respondent's exhibits A through K 15 days prior to the hearing before this Court filed.
- Nov. 25—Designation of record filed by taxpayer with proof of service thereon. [4]

The Tax Court of the United States
Docket No. 7116

LEO M. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above-named petitioner hereby petitions this court for a redetermination of his federal income tax liability for the taxable years ended December 31st, 1939, December 31, 1940, and December 31, 1941, as determined by the Commissioner of Internal Revenue in a notice of deficiency (Bureau symbols LA:IT:90D:PAK), and as a basis of this proceeding alleges as follows:

1. That the petitioner is an individual and that his address is 6200 Avalon Boulevard, Los Angeles 3, California; that he filed returns for the years involved herein with the Collector of the Sixth District of California; and that he kept his books and filed his returns on the accrual basis.

2. That a notice of deficiency, a copy of which marked Exhibit "A" is attached hereto, was mailed to the petitioner on November 17th, 1944.

3. That the deficiencies determined by the Commissioner were as follows:

1939—\$2,356.84

1940—\$5,225.29

1941—\$8,069.72; [5]

and that the amounts involved in this proceeding are:

1939—\$2,401.75

1940—\$5,397.79

1941—\$10,482.42

or such other amounts as the Court may determine.

4. That the determination of taxes as set forth in said notice of deficiency is based upon the following errors:

- (a) The treatment as ordinary income, instead of capital gain, of the gain derived by the petitioner under the so-called Gerrard contract of March 21, 1938.
- (b) The failure to allow, as an offset against the selling price in determining the amount of such gain, costs totaling \$111,500.
- (c) The failure to allow amounts totaling \$10,500 payable and paid in each of the taxable years here involved as deductions under Sections 23(a)(2) of the Internal Revenue Code. (This is alternative to assignment of error (b).)
- (d) The failure to allow the full amount of California State income taxes accrued.

5. The facts upon which the petitioner relies as sustaining the above assignments of error are as follows:

A. With respect to assignment of error (a):

1. On or about March 21, 1938, the petitioner sold to The Gerrard Company, Inc. (hereinafter referred to as "Gerrard"), certain patents taken out

by him on flat wire tying machines and round wire tying machines, for a total consideration of \$425,000. Said patents were the community property of petitioner and his wife, Lena P. Harvey, and were all acquired after July, 1927. Of said patents, 7.292% in value were acquired not more than 18 months prior to said sale and 92.708%, more than 24 months prior to said sale.

2. Of said total consideration \$25,000 was payable and paid in cash upon execution of the sale; and the balance of \$400,000 was [6] payable and paid at the same time by delivery to petitioner of ten negotiable promissory notes in his favor in the sum of \$40,000 each, all dated April 2, 1938, and maturing serially beginning on the 2nd day of April, 1939, and on April 2 of each year thereafter, each of them in the form, with necessary variations as to dates and numbers, set forth in Exhibit "B" hereto attached and made a part hereof. The American Steel and Wire Company of New Jersey, shown in Exhibit "B" as joint maker, was the parent company of Gerrard.

3. Those of said notes of \$40,000 each which were due in the years involved herein were paid when due.

4. In filing his return for the year 1938, petitioner elected to return his gain from the said sale of patents on the installment basis under Section 44(b) of the Revenue Act of 1938 but otherwise he filed his return for the year 1938 on the accrual basis.

5. The said patents, both on flat wire tying machines and on round wire tying machines, were at the time of sale under exclusive license to Gerard. There were four such licenses, each covering a separate group of patents, as follows:

- (a) A license dated February 25, 1930, covering United States patents on flat wire tying machines, hereinafter referred to as "domestic flat band patents."
- (b) A license dated February 25, 1930, covering patents issued by foreign countries on flat wire tying machines, hereinafter referred to as "foreign flat band patents."
- (c) A license dated July 5, 1929, covering United States patents on so-called "TA" round wire tying machines, hereinafter referred to as "domestic round wire patents," together with an agreement under the same date giving in effect similar treatment to patents owned not by petitioner but by Gerard on so-called "TI" and "TE" round wire tying machines.
- (d) A license dated February 25, 1930, covering patents issued by foreign countries on so-called "TA" round wire tying [7] machines, hereinafter referred to as "foreign round wire patents."

Under date of October 12, 1936, an amendment of said license agreements was made and the payments to petitioner under the license agreements as so amended were guaranteed by the said American Steel and Wire Company of New Jersey.

6. Under the said licenses Gerrard had the sole and exclusive right for the entire life of said patents to use, lease and vend the machines covered by said patents, without obligation, however, to use, lease or vend any of them; and as a result of the said licenses, no substantial rights in the said patents remained to petitioner except the right to receive such minimum royalties as were provided under the licenses.

7. Under the said license of domestic flat band patents there was a minimum royalty payable by Gerrard to petitioner of \$15,000 per year; and under the said license of foreign flat band patents there was a minimum royalty payable by Gerrard to petitioner of \$15,000 per year. The said minimum royalty of \$15,000 per year under each license was payable as long as any patent covered by such license was unexpired. Among the patents covered by each license were patents issued as late as 1937.

8. On the date of sale of said patents, the right to receive said minimum royalty of \$15,000 per year under each of the two flat band licenses, or \$30,000 per year altogether, was in full force and effect and had a reasonable present value of \$425,000.

9. The round wire licenses carried no minimum royalties and the rights of petitioner under said round wire licenses and the [8] patents covered thereby had not more than a nominal value.

10. Petitioner was in the machine shop business manufacturing any kind of machines on order.

11. Petitioner was not a dealer in patents and was not in the business of selling patents.

12. None of said patents were stock in trade of petitioner.

13. None of said patents were other property of a kind which would properly be included in the inventory of the petitioner if on hand at the close of the taxable year.

14. None of said patents were held by petitioner primarily for sale to customers in the ordinary course of his trade or business.

15. No patents of any kind were ever held by petitioner primarily for sale to customers in the ordinary course of his trade or business.

16. Gerrard was not a customer for said patents in the ordinary course of petitioner's trade or business.

17. Said sale of patents was not made by petitioner in the ordinary course of his trade or business.

18. The said flat band patents were not used in petitioner's trade or business.

19. Only experimental models of the flat band machines were ever manufactured by petitioner; and insofar as petitioner knows, none were ever manufactured or sold by Gerrard.

20. Under the said licenses of flat band patents the only royalties ever received by petitioner were the minimum royalties provided for thereunder.

B. With respect to assignment of error (b):

1. In connection with the said patents and the

sale thereof, petitioner incurred costs totaling \$111,500 as shown by Exhibit "C" attached hereto which is a copy of Exhibit B and Exhibit B-1 of the report dated January 29, 1940, of George D. Martin, Internal Revenue Agent in Charge, Los Angeles, California, on the examination by his office of the return of petitioner for the year 1938.

2. The statements made in said Exhibit "C" under items (b) and (c) thereof are explanatory, respectively, of the amounts of \$85,000 and \$26,500 shown in the computation in said exhibit as payments due Lawrence A. Harvey and Herbert Harvey. Said statements are correct except that (1) the sale of said patents was to Gerrard only and not to Gerrard and the American Steel & Wire Company, although both companies were makers on the ten notes received by petitioner totaling \$400,000 out of the aggregate consideration of \$425,000, and (2) that the services of Lawrence A. Harvey included also aid and assistance in the negotiation of the said sale of patents.

3. Because of said costs totaling \$111,500, only 313,500/425,000, or 73.7647%, of each payment of \$40,000, or \$29,505.88, is the amount of gain derived from said sale of patents applicable to each of the years here involved; of said \$29,505.88, 7.292% (see exhibit "C") or \$2,151.57 is includible in gross income at 100% and the balance of \$27,354.31 at 50% under Section 117(b) of the Internal Revenue Code; and that the amount so includible in gross income is one-half his and one-half

that of his wife, Lena P. Harvey, by virtue of the community property laws of California. [10]

C. With respect to assignment of error (c):

1. Of the payments shown in Exhibit "C" as due Lawrence A. Harvey in the total amount of \$85,000, or 20% of the said consideration of \$425,000, \$5,000 was payable and paid in 1938 and the balance of \$80,000 was payable pro rata as and when the said notes totaling \$400,000 were paid to petitioner. Of said balance of \$80,000, \$8,000 was accordingly payable and paid by petitioner to said Lawrence A. Harvey in each of the years here involved.

2. Of the payments shown in Exhibit "C" as due Herbert Harvey in the total amount of \$26,500, \$1,500 was payable and paid in 1938 and the balance of \$25,000 was payable pro rata as and when the said notes totaling \$400,000 were paid to petitioner. Of said balance of \$25,000, \$2,500 was accordingly payable and paid by petitioner to said Herbert Harvey in each of the taxable years here involved.

D. With respect to assignment of error (d):

1. Additional income taxes have been asserted against petitioner by the Franchise Tax Commissioner of the State of California as follows:

1939\$ 642.88
1940 1,034.82
1941 4,618.61

2. The amounts allowed by the Commissioner as additional California income taxes for the same years as shown in Exhibit "A" attached hereto rep-

resented the additional California income taxes payable if petitioner is correct with respect to assignment of error (a) and assignment of error (b). The additional California income taxes payable are, however, \$642.88, \$1,034.82 and \$4,618.61 for the respective years if petitioner is correct with respect to assignment [11] of error (b) but not with respect to assignment of error (a). No determination has yet been made by the Franchise Tax Commissioner as to the additional state income taxes which will be due on any other assumption with respect to assignments of error (a), (b) and (c).

Wherefore, petitioner prays that the Court:

- (a) Redetermine the taxes of petitioner for the years 1939, 1940 and 1941;
- (b) Determine that there is no deficiency due by this petitioner; and
- (c) Determine that the petitioner has overpaid his tax for the years 1939, 1940 and 1941.

/s/ GEORGE T. ALTMAN,

Attorney for Petitioner. [12]

State of California,
County of Los Angeles—ss.

Leo M. Harvey, being duly sworn, deposes and says: That he is the petitioner above named; that he has read the foregoing petition, and is familiar with the statements contained herein, and that the facts therein stated are true.

/s/ LEO M. HARVEY.

Subscribed and sworn to before me this 8th day of February, 1945.

[Seal] /s/ ALICE E. WIEDER,

Notary Public in and for said
County and State.

My Commission expires July 1, 1947. [13]

EXHIBIT "A"

Treasury Department, Internal Revenue Service
417 South Hill Street, Los Angeles 13, California
Nov. 17, 1944.

Office of Internal Revenue Agent in Charge, Los
Angeles Division, LA:IT:90D:PAK.

Mr. Leo M. Harvey
6200 Avalon Boulevard
Los Angeles 3, California.

Dear Mr. Harvey:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1939, December 31, 1940 and December 31, 1941, discloses a deficiency of \$15,651.84, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby give of the deficiency or deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,

Commissioner,

By /s/ GEORGE D. MARTIN,

Internal Revenue Agent
in Charge.

PAK:vac

Enclosures:

Statement

Form of waiver [14]

STATEMENT

LA:IT:90D:PAK

Mr. Leo M. Harvey

6200 Avalon Boulevard

Los Angeles 3, California

Tax Liability for the Taxable Years Ended

December 31, 1939, December 31, 1940 and December 31, 1941

Years	Liability	Assessed	Deficiency
1939	\$ 3,926.10	\$ 1,569.27	\$ 2,356.83
1940	12,331.96	7,106.67	5,225.29
1941	47,854.45	39,784.73	8,069.72
Totals	\$64,112.51	\$48,460.67	\$15,651.84

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated August 5, 1943, to your protest dated January 4, 1944, and to the statements made at conferences held on January 21, June 6, July 6 and July 27, 1944.

In your income tax returns for each of the years 1939, 1940 and 1941 you reported community income received under the so-called "Gerrard Contract" of March 21, 1938, as follows:

	Total Gain	Sec. 117 Limitation	Community Share Reported
Short-term capital gain.....	\$ 2,151.57	\$ 2,151.57	\$1,075.79
Long-term capital gain.....	27,354.31	13,677.15	6,838.58

It is determined that the entire \$40,000.00 received in each year is taxable as ordinary income. Your community share of this income has accordingly been increased in each year by the amount of \$12,085.63 from the \$7,914.37 (total reported as above) to \$20,000.00.

A copy of this letter and statement has been mailed to your representative, Mr. George T. Altman, 215 West Seventh Street, Los Angeles 14, California, in accordance with the authority contained in the power of attorney executed by you.

ADJUSTMENTS TO NET INCOME

Taxable Year Ended December 31, 1939

Net income as disclosed by return.....		\$ 9,059.36
Additional income and unallowable deductions:		
(a) Increase in income from Ger-rard contract	\$12,085.63	
(b) Increase in partnership income	9,849.10	21,934.73
		<hr/>
Total.....		\$30,994.09
Additional deduction:		
(c) Additional California income tax allowed		299.43
		<hr/>
Net income adjusted.....		\$30,694.66

Explanation of Adjustments

(a) This adjustment has been previously explained.

(b) There has been added the amount of \$9,849.10 to the income reported on your return from the partnership, Harvey Machine Co.

(c) A deduction for additional accrued California income tax is allowed in the amount of \$299.43.

COMPUTATION OF TAX

Taxable Year Ended December 31, 1939

Net income adjusted.....		\$30,694.66
Less: Personal exemption	\$ 666.67	
Credit for dependents.....	1,166.67	1,833.34
		<hr/>
Balance surtax net income.....		\$28,861.32
Less: Earned income credit.....		300.00
		<hr/>
Balance subject to normal tax.....		\$28,561.32
Normal tax at 4% of \$28,561.32.....	\$ 1,142.45	
Surtax on \$28,861.32.....	2,783.65	
		<hr/>
Correct income tax liability.....		\$ 3,926.10
Income tax assessed:		
Original, account No. 202699.....	\$ 418.34	
Additional, December 31, 1943,		
No. 519016	1,150.93	1,569.27
		<hr/>
Deficiency of income tax.....		\$ 2,356.83

ADJUSTMENTS TO NET INCOME

Taxable Ended December 31, 1940

Net income as disclosed by return.....		\$25,509.17
Additional income and unallowable deductions:		
(a) Increase in income from Gerrard contract	\$12,085.63	
(b) Increase in partnership income	7,894.35	
(c) Additional rental income.....	269.98	
(d) Bad debts disallowed.....	414.82	20,664.78
	<hr/>	<hr/>
Total		\$46,173.95
Additional deduction:		
(e) Additional California income tax allowed		505.87
		<hr/>
Net income adjusted.....		\$45,668.08

Explanation of Adjustments

(a) This adjustment has been previously explained.

(b) There has been added the amount of \$7,894.35 to the income reported on your return from the partnership, Harvey Machine Co.

(c) Income from rentals is increased by \$269.98 representing your community one-half of rental income from the Webster Apartments not included in income on your return.

(d) Bad debts aggregating \$829.64 have been disallowed as a deduction under section 23(k) of the Internal Revenue Code. One-half of that amount, or \$414.82, is applicable to your return.

(e) A deduction is allowed for additional accrued California income tax in the amount of \$505.87.

The earned income credit claimed in your return in the amount of \$816.13 is reduced to \$565.95, the amount allowable under section 25 (a) (4) of the Internal Revenue Code.

COMPUTATION OF ALTERNATIVE TAX

Taxable Year Ended December 31, 1940

Net income adjusted.....		\$45,668.08
Minus: Net long-term capital gain.....		174.60
		<hr/>
Ordinary net income.....		\$45,493.48
Less: Personal exemption.....	\$ 600.00	
Credit for dependents.....	800.00	1,400.00
		<hr/>
Balance (surtax net income).....		\$44,093.48
Less: Earned income credit.....		565.95
		<hr/>
Net income subject to normal tax.....		\$43,527.53
Normal tax at 4% on.....	\$43,527.53	\$ 1,741.10
Surtax on	\$44,093.48	9,417.39
		<hr/>
Partial tax.....		\$11,158.49
Plus: 30% of net long-term capital gain.....		52.38
		<hr/>
Alternative tax		\$11,210.87

COMPUTATION OF TAX

Taxable Year Ended December 31, 1940

Net income adjusted.....		\$45,668.08
Less: Personal exemption	\$ 600.00	
Credit for dependents.....	800.00	1,400.00
		<hr/>
Balance (surtax net income).....		\$44,268.08
Less: Earned income credit.....		565.95
		<hr/>
Net income subject to normal tax.....		\$43,702.13
Normal tax at 4% on.....	\$43,702.13	\$ 1,748.09
Surtax on	\$44,268.08	9,487.23
		<hr/>
Total		\$11,235.32
Alternative tax		\$11,210.87
Defense tax (10% of \$11,210.87).....		1,121.09
		<hr/>
Correct income tax liability.....		\$12,331.96

Income tax assessed:

Original, account No. 205761.....	\$ 4,247.32
Additional, December 31, 1943	
No. 519017	2,859.35

Total income tax assessed.....	7,106.67
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Deficiency of income tax.....	\$ 5,225.29
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ADJUSTMENTS TO NET INCOME

Taxable Year Ended December 31, 1941

Net income as disclosed by return.....	\$48,967.08
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Additional income:

(a) Increase in income from Gerrard contract.....	\$12,085.63	
(b) Increase in partnership in- come	37,428.30	\$49,513.93

Total	\$98,481.01
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Additional deductions:

(c) Dividends received over- stated	\$ 17.16	
(d) Long-term capital gain re- duced	1,904.19	
(e) Additional California in- come tax allowed.....	3,711.84	5,633.19

Net income adjusted.....	\$92,847.82
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Explanation of Adjustments

(a) This adjustment has been previously explained.

(b) There has been added the amount of \$37,428.30 to the income reported on your return from the partnership, Harvey Machine Co.

(c) Dividends received were overstated by the amount of \$15.05 from Harcraft Co. and \$19.27 from U. S. National Bank. One-half of those amounts or \$17.16 is applicable to your return.

(d) In your return you reported a long-term capital gain of \$1,904.19 representing your community half of a total long-term capital gain of \$3,808.38 from the sale of cup machines, patents and equipment. It has been determined that this income constitutes income to the partnership, Harvey Machine Co., and is

included in the adjustment of partnership income under item (b) above. The long-term capital gain reported in your return from this sale is, accordingly, eliminated.

(e) A deduction for additional accrued California income tax is allowed in the amount of \$3,711.84.

COMPUTATION OF ALTERNATIVE TAX

Taxable Year Ended December 31, 1941

Net income adjusted.....			\$92,847.82
Minus: Net long-term capital gain.....			589.66
			<hr/>
Ordinary net income			\$92,258.16
Less: Personal exemption	\$	350.00	
Credit for dependents.....		800.00	1,150.00
			<hr/>
Balance (surtax net income).....			\$91,108.16
Less: Earned income credit.....			1,400.00
Net income subject to normal tax.....			\$89,708.16
Normal tax at 4% on.....	\$89,708.16	\$	3,588.33
Surtax on	91,108.16		44,089.22
Partial tax			\$47,677.55
Plus: 30% of net long-term capital gain.....			176.90
			<hr/>
Alternative tax			\$47,854.45

COMPUTATION OF TAX

Taxable Year Ended December 31, 1941

Net income adjusted.....			\$92,847.82
Less: Personal exemption	\$	350.00	
Credit for dependents.....		800.00	1,150.00
			<hr/>
Balance (surtax net income).....			\$91,697.82
Less: Earned income credit.....			1,400.00
			<hr/>
Net income subject to normal tax.....			\$90,297.82
Normal tax at 4% on.....	\$90,297.82	\$	3,611.91
Surtax on.....	91,697.82		44,466.60
			<hr/>
Total			\$48,078.51
Alternative tax			\$47,854.45
Correct income tax liability.....			\$47,854.45

Income tax assessed:

Original, account No. 340838.....	\$20,036.07
Additional, December 31, 1943	
No. 519018	19,748.66

Total income tax assessed.....	39,784.73
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Deficiency of income tax.....	\$ 8,069.72
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EXHIBIT B

Cleveland, Ohio

Dated April 2, 1938.

Note No. 1 Due April 2, 1939

Twelve (12) months after date, we jointly and severally promise to pay to the order of Leo M. Harvey the sum of Forty Thousand Dollars (\$40,000.00) together with interest at the rate of two per cent (2%) per annum, without defalcation, for value received. Interest payable quarterly. The drawers and endorsers, severally waive presentment for payment, demand, protest, notice of protest and dishonor and non-payment, of this note. Payable at Union Bank & Trust Co. of Los Angeles.

This note is one of a series of notes made by the same makers to the same payee in the same amount numbered one to ten inclusive, each dated April 2, 1938, No. 1 being payable April 2, 1939, No. 2, April 2, 1940, No. 3, April 2, 1941, No. 4, April 2, 1942, No. 5, April 2, 1943, No. 6, April 2, 1944, No. 7, April 2, 1945; No. 8, April 2, 1946, No. 9, April 2, 1947, and No. 10, April 2, 1948.

Upon default in the payment of principal or interest of any one of the above enumerated notes, one to ten inclusive, any and/or all of the said notes from one to ten inclusive, shall at the option of the holders thereof become immediately due and payable, together with costs of collection, including such reasonable attorney's [22] fees as a court of competent jurisdiction may determine.

THE GERRARD COMPANY,
INC., a Delaware Corporation

By,
Executive Vice President.

By,
Assistant Secretary.

[Seal] THE AMERICAN STEEL AND
WIRE COMPANY OF NEW
JERSEY

By,
President.

Attest:

.....,
Treasurer and Secretary.

L.M.H.:W.B.

EXHIBIT C

INSTALLMENT PROFITS REALIZED

In re: Sale of Patents

Total sale price.....		\$425,000.00
Less: Cost of patents.....	None	
Payments due Lawrence A. Harvey	\$85,000.00	
Payments due Herbert Harvey	26,500.00	111,500.00
Net profit to be realized.....		313,500.00
Profit percentage		73.7647%
Installment payment received—Year 1938.....		\$ 25,000.00

	Short Term	Long Term	Total
Sales allocation	7.292%	92.708%	100%
Profit allocation at 73.7647%	\$1,344.73	\$17,096.45	\$ 18,441.18
Taxable at	100%	50%	
Taxable profits.....	1,344.73	8,548.23	
Profits reported.....	1,713.62	10,893.19	
Profits corrected.....	1,344.73	8,548.23	
Net reductions.....	\$ 368.89	\$ 2,344.96	

Explanation of Items

(a) Major portion of the patents sold were about ten years old; no cost data capitalized, and none claimed.

(b) Represents 20% of the total sales price, payable to Lawrence A. Harvey, who is an attorney, for legal services, etc., in connection with patent research work, drawing up sales contracts covering the various patents, both domestic and foreign, prior to sale of taxpayer's patents to The Gerrard Co., Inc., and the American Steel and Wire Company.

(c) Represents amount payable to Herbert Harvey for engineering and mechanical work and assistance during prior years in the development of the various patents; it is a verbal agreement.

[Endorsed]: Received and filed Feb. 12, 1945.

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that there are in controversy income tax deficiencies for the taxable years ended December 31, 1939, 1940 and 1941; denies the remaining allegations contained in paragraph 3 of the petition.

4. (a) to (d), inclusive. Denies the allegations of error contained in all subparagraphs, (a) to (d), inclusive, of paragraph 4 of the petition. [25]

5. (A)(1) Admits the allegations contained in the first sentence and denies the remaining allegations of subparagraph (A)(1) of paragraph 5 of the petition.

(A)(2) to (A)(4), inclusive. Admits the allegations contained in subparagraphs (A)(2) to (A)(4), inclusive, of paragraph 5 of the petition.

(A)(5) For lack of sufficient information to form a conclusion as to the truth and correctness of the allegations contained in subparagraph (A)(5) of paragraph 5 of the petition, respondent denies said allegations.

(A)(6) to (A)(20), inclusive. Denies the allegations contained in subparagraphs (A)(6) to (A)(20), inclusive, of paragraph 5 of the petition.

(B)(1) to (B)(3), inclusive. Denies the allegations contained in subparagraphs (B)(1) to (B)(3), inclusive, of paragraph 5 of the petition.

(C)(1) and (C)(2) Denies the allegations contained in subparagraphs (C)(1) and (C)(2) of paragraph 5 of the petition. [26]

(D)(1) and (D)(2). Denies the allegations contained in subparagraphs (D)(1) and (D)(2) of paragraph 5 of the petition.

6. Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL, ECC

Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,

Division Counsel.

E. C. CROUTER,

Special Attorney,

Bureau of Internal Revenue.

ECC/ve 3/12/45

[Endorsed]: Received and filed March 19, 1945.

The Tax Court of the United States

Docket No. 7116

LEO M. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 7117

LENA P. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

MOTION TO AMEND PETITIONS

Petitioners move the court for leave to amend their respective petitions by addition of the following paragraph preceding the prayer of each petition:

“6. Because of the election of accelerated amortization under Section 124(d) of the Internal Revenue Code by Harmac Co., a copartnership, in which Leo M. Harvey has a two-thirds interest, petitioner requests a finding for additional overpayment in the amount of \$322.22 for 1941.”

Petitioners further move that this motion be deemed such amendment. [28]

Reason for Motion

The recomputation of the amortization of emergency facilities in the case of the said Harmac Co. for 1941 is shown on the statement attached hereto. As there shown, there is a resulting reduction of the net income of petitioner in the amount of \$495.72 for that year. The effect upon the tax is a reduction therein in the amount of \$322.22.

/s/ GEORGE T. ALTMAN,
Attorney for Petitioner, 215 West 7th Street, Los
Angeles 14, California. [29]

State of California,
County of Los Angeles—ss.

Leo M. Harvey, being duly sworn, deposes and says: That he is one of the petitioners above named; that he has read the foregoing motion and is familiar with the statements contained therein, and that the facts therein stated are true.

/s/ LEO M. HARVEY.

Subscribed and sworn to before me this 26th day of August, 1946.

[Notary Seal]

/s/ WILLIAM S. PEARSON,
Notary Public in and for said
County and State.

My Commission Expires June 30, 1950.

State of California,
County of Los Angeles—ss.

Lena P. Harvey, being duly sworn, deposes and says: That she is one of the petitioners above named; that she has read the foregoing motion and is familiar with the statements contained therein, and that the facts therein stated are true.

/s/ LENA P. HARVEY.

Subscribed and sworn to before me this 26th day of August, 1946.

[Notary Seal]

/s/ WILLIAM S. PEARSON,

Notary Public in and for said
County and State.

My Commission Expires June 30, 1950. [30]

RECOMPUTATION OF AMORTIZATION OF EMERGENCY FACILITIES OF HARMAC CO. FOR
1941 UNDER INTERNAL REVENUE CODE, SECTION 124(d)

Item	Date Acquired	Cost	Taken	Depreciation or Amortization	
				Sec. 124(d)	
Hand Mill	March, 1941	\$ 180.25	\$ 27.14	\$ 30.04	
Press	June, 1941	24,795.05	1,570.06	2,917.06	
Power Press Brake	November, 1941	1,163.90	19.36	25.30	
Press Brake Machine	April, 1942	7,458.05	994.43	1,125.74	
			<hr/>		
			\$2,610.99	\$4,098.14	
			<hr/>		
Deduct amortization taken				2,610.99	

Increases in amortization by virtue of election under sec. 124(d)
of amortization period ended with the month of September,
1945

\$1,487.15

Leo M. Harvey partnership interest in Harmac Co.— $\frac{2}{3}$ rds;
therefore $\frac{2}{3}$ rds of above amount

\$ 991.44

\$ 495.72

\$ 495.72

Lena P. Harvey— $\frac{1}{2}$

[Endorsed]: Received and Filed Sept. 6.

[Title of Tax Court and Cause.]

ORDER

These proceedings came on for hearing on October 9, 1946, at Washington, D. C., on petitioner's motion to amend petitions. Counsel for the respondent offered no objection thereto. After due consideration, it is

Ordered: That petitioner's motion to amend petitions, filed on September 6, 1946, is granted.

[Seal] /s/ BOLON B. TURNER,
Judge.

Dated October 9, 1946, Washington, D. C. [32]

[Title of Tax Court and Cause.]

MOTION

Petitioners move the Court for leave to amend their respective petitions as follows:

1. The last sentence of subparagraph 1 of paragraph 5-A is amended to read as follows:

“All of said patents were acquired more than 24 months prior to the date of said sale.”

2. After subparagraph 20 of paragraph 5-A, the following subparagraphs are added:

“21. The notes totalling \$400,000 referred to in subparagraph 2 above had a fair market value of \$400,000 at the time received by petitioner Leo M. Harvey.” [33]

“22. Said petitioner at no time was a person who regularly sells or otherwise disposes of property on the installment plan.”

Petitioners further move the Court that this motion be deemed the amendment of the petitions.

Dated Los Angeles, California, November 4th, 1946.

/s/ GEORGE T. ALTMAN,
Attorney for Petitioners, 215 West 7th Street, Los Angeles 14, California.

Granted Nov. 4, 1946.

/s/ SAMUEL B. HILL,
Judge.

[Endorsed]: Filed Nov. 4, 1946.

Copy served. [34]

The Tax Court of the United States

Docket No. 7116

LEO M. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ANSWER TO PETITION AS AMENDED

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal

Revenue, and denies all the allegations contained in paragraph 6 of the petition as amended.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL, ECC

Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,

Division Counsel.

EARL C. CROUTER,

E. A. TONJES,

Special Attorneys,

Bureau of Internal Revenue.

EAT/ftc 11/4/46

[Endorsed]: Filed Nov. 8, 1946. [35]

[Title of Tax Court and Cause.]

ANSWER TO AMENDMENT TO PETITION

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the amendment to the petition of the above-named taxpayer, admits and denies as follows:

1. Denies the amendment to the last sentence of subparagraph 1 of paragraph 5-A of the petition, reading as follows:

“All of said patents were acquired more than 24 months prior to the date of said sale.”

2. Denies the allegations contained in subparagraphs 21 and 22 of paragraph 5-A of the petition, as amended.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL, ECC
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

EARL C. CROUTER,

E. A. TONJES,

Special Attorneys,

Bureau of Internal Revenue.

EAT/mmb 11/6/46.

[Endorsed]: Filed Nov. 8, 1946.

Copy served. [36]

[Title of Tax Court and Cause.]

MOTION FOR JUDGMENT ON THE
PLEADINGS

Petitioner moves the Court for judgment on the pleadings.

If this motion is placed upon the calendar for argument, petitioner requests that it be so placed upon the Los Angeles calendar if that is possible.

Reason for Motion

In subparagraph (A)(4) of paragraph 5 of the petition, petitioner alleged that in filing his return for 1938 he elected to return his gain from a certain sale of patents on the installment basis under Section 44(b) of the Revenue Act of 1938 but otherwise filed his return for 1938 on the accrual basis. Respondent in his answer has admitted this allegation.

Respondent, however, has denied all of petitioner's allegations contained in subparagraphs (A)(6) to (A)(20), inclusive, of paragraph 5 of the petition. If any one of the allegations in paragraphs (A)(11) to (A)(17), inclusive, of paragraph 5 of the petition is untrue, then petitioner had no right to make the installment election referred to above and no part of the income from said sale is includable in the [37] gross income of petitioner for any of the years involved in this proceeding. Petitioner asks for judgment on the pleadings based upon that conclusion.

Petitioner desires to make it clear for the purpose of the record that he is not maintaining the position that any of the allegations made by him in paragraphs (A)(11) to (A)(17), inclusive, of subparagraph 5 of the petition is untrue. On the contrary he reaffirms the truth of said allegations. The conclusion stated above that no part of the income from said sale of patents should be included in gross income of petitioner for the years herein involved is merely a necessary corollary of the position taken by respondent. The position maintained by peti-

tioner remains the same as stated in his petition and petitioner now and hereby reaffirms that position.

Wherefore, it is prayed that this motion for judgment on the pleadings be granted.

/s/ GEORGE T. ALTMAN,
Attorney for Petitioner, 215 West 7th Street, Los
Angeles 14, California.

Dated Los Angeles, California, March 28th, 1945.

[Endorsed]: Received and filed April 2, 1945.

Denied May 17, 1945.

/s/ J. E. MURDOCK,
Judge.

Copies served on both parties. [38]

The Tax Court of the United States

Docket Nos. 7116, 7117

LEO M. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

LENA P. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

George T. Altman, Esq., for the petitioners.

E. A. Tonjes, Esq., for the respondent.

MEMORANDUM FINDINGS OF FACT
AND OPINION

Hill, Judge: Respondent determined deficiencies in petitioner's income tax as follows:

Docket No.	1939	1940	1941
7116 Leo M. Harvey	\$2,356.83	\$5,225.29	\$8,069.72
7117 Lena P. Harvey	2,356.84	5,225.29	8,069.72

The questions are (1) whether the gain realized by petitioners on account of the installment sale of certain patents constituted capital or [39] ordinary gain, and (2) whether certain percentages of the sales price paid by petitioners to others can properly be excluded or deducted by petitioners

from the sales price received by them. Petitioners filed separate returns for the taxable years with the collector of internal revenue for the sixth district of California at Los Angeles on a community and accrual basis. The cases were consolidated for hearing.

FINDINGS OF FACT

Petitioners are husband and wife residing in Los Angeles. Unless otherwise indicated petitioner will hereinafter refer to petitioner Leo M. Harvey.

By written agreement dated March 21, 1938, petitioner sold certain patents and applications for patents, both foreign and domestic, to the Gerrard Company, Inc., hereinafter referred to as Gerrard. The patents so sold by petitioner covered inventions in the round wire tying and the flat band strapping and tying fields. As here material, Gerrard paid petitioner as consideration \$25,000 cash upon execution of the agreement and delivered to petitioner 10 negotiable promissory notes, each in the amount and each having then a fair market value of \$40,000, all dated April 2, 1938, numbered 1 to 10, inclusive, and maturing serially commencing April 2, 1939, and thereafter on April 2 of each succeeding year through April 2, 1948. These notes were tendered and accepted as payment. During the taxable years here involved these notes were paid when due.

By written agreement and under circumstances hereinafter described petitioner paid his son Lawrence 20 per cent of the proceeds of the sale as received by petitioner. Petitioner also paid certain

amounts to his brother Herbert from such proceeds. Herbert was thus paid \$2,500 in each of the taxable years here involved. [40]

In reporting the proceeds of the sale for income tax purposes petitioners excluded or deducted from the sales price certain amounts on account of such obligations or payments to Lawrence and Herbert. The remainder of the sales price was reported on the installment basis and treated as capital gain, each petitioner reporting a community one-half. Thus, petitioners reported as taxable gain to be taken into account from the sale the amount of \$15,828.72 for each of the taxable years here involved, each petitioner reporting a community half thereof, or \$7,914.37.¹ Respondent determined that the entire proceeds received constituted ordinary income to petitioners and not capital gain. Respondent in this connection stated:

It is determined that the entire \$40,000.00 received in each year is taxable as ordinary income. Your community share of this income has accordingly been increased in each year by the amount of \$2,085.63 from the \$7,914.37 (total reported as above) to \$20,000.00.

Petitioner's son, Lawrence, was an attorney about 28 years old in 1938. He assisted petitioner in negotiating the sales contract with Gerrard. Petitioner agreed in writing dated April 2, 1938, to compen-

¹The figure of \$7,914.37 was the one actually reported rather than \$7,914.36.

sate Lawrence for his efforts in this connection by paying him 20 per cent of all proceeds of the sale as received by petitioner. Under this agreement petitioner paid Lawrence \$8,000 a year during the taxable years. Petitioner also employed as attorneys in connection with the Gerrard deal, Max Schlesinger, who handled the tax aspects, one Rubin and a Walter Sheldon. Walter Sheldon was paid \$22,500 in 1938 by petitioner for his services, which services among others concluded Sheldon's work in connection with the Gerrard sale. [41]

Petitioner's brother, Herbert, had been an employee of petitioner since about 1918 on a salary ranging from \$500 to \$1,500 a month. Petitioner, since about 1914, had been sole proprietor of a business known as Harvey Machine Company. This business consisted primarily of making industrial machinery on special order. Herbert was employed in connection with this business.

Petitioner with the advice and assistance of Herbert had commenced developing inventions in the wire tying field in the middle 1920's and subsequent thereto and from time to time obtained the patents sold to Gerrard. The expense of developing these inventions were deducted as business expenses of Harvey Machine Company. Some time in 1930 petitioner licensed Gerrard to operate under certain of the flat wire tying patents at a minimum royalty of \$30,000 a year, which petitioner received from 1931 to 1937, inclusive. In 1938 and by the terms of the sales contract Gerrard agreed to pay petitioner certain amounts on account of royalties due

up to and including March 31, 1938. These royalty payments were reported by petitioner as income from the business of Harvey Machine Company. Petitioner had paid Herbert 10 per cent of the \$30,000 annual minimum royalty received by petitioner from Gerrard. The sales contract with Gerrard stated that it was understood between the parties that the patents involved and referred to as owned by petitioner included not only those owned by petitioner but "also patents, patent applications and inventions, if any, owned by Herbert Harvey * * *." [42]

OPINION

While it may be doubtful whether the patents involved constituted petitioner's stock in trade or property of a kind which would properly be included in inventory or property held primarily for sale to customers in the ordinary course of business, we think it is clear that such patents constituted property used in the trade or business of a character which is subject to the allowance of depreciation. Such patents did not, therefore, constitute capital assets within the meaning of section 117 (a) of the Internal Revenue Code, and the gain from their sale was ordinary income and not subject to the percentage limitations of section 117 (b).

The development and patenting of the inventions and the licensing appears to us a normal, logical and natural phase of petitioner's business of machinist. The expenses of developing the inventions were deducted as business expenses and the royal-

ties were treated as income of the business. Petitioner received a minimum royalty of \$30,000 a year for at least seven years or a total of \$210,000 before their final sale for \$425,000. It is impossible for us to consider petitioner's income-producing activities in connection with these patents as a mere hobby or recreation or as an isolated or casual affair such as to characterize them in terms other than those connotating business use. We are satisfied that the record supports the conclusion that petitioner used the patents in his business. That such patents, under the circumstances, were subject to the allowance for depreciation provided in section 23 (1) seems sufficiently apparent as to require no discussion.

Petitioner argues that the patent activities had no connection with [43] his business which was making machines on special order. Petitioner further argues that the mere passive role of receiving royalties can not be considered a business. We think these arguments subject the facts to a strained and unnatural interpretation. We can see no reason or necessity for limiting the scope of petitioner's business carried on in the name of Harvey Machine Company to the making of machinery on special order and excluding therefrom the inventive activity that did in fact co-exist in the making of machinery. The expenses of this inventive activity were deducted as a business expense of Harvey Machine Company and the royalty income was included as income of the Harvey Machine Company.

Nor do we consider it realistic to look only at the receipt of royalties divorced from the efforts and accomplishments leading up to such receipt and to say such passive receipt does not constitute a business. We conclude therefore that the patents in question were used by petitioner in his business and were subject to depreciation. It follows that they were not capital assets and that the gain from their sale constituted ordinary income as respondent determined.

Petitioner does not contend that Lawrence had an interest in the patents but does contend that the 20 per cent of the sales price paid to Lawrence constituted a necessary expense of the sale. Inter-family transactions inevitably invite special scrutiny and in the instant case we are not satisfied and do not think petitioner has sufficiently established the nature and value of Lawrence's services. Lawrence was an attorney and did render some assistance to his father but other lawyers were also on hand and we know that at least one of them received very substantial payments for his services. The amount of \$85,000 [44] promised Lawrence seems to us an almost incredible fee for the nebulous services described in the record. We can not but believe that Lawrence's filial status more than his services were determinative. Lawrence did not testify at the hearing. We have only petitioner's very vague recitations as to his son's services. Under these circumstances we must conclude that petitioner has failed to sustain the burden of proof. It follows

that respondent's determination in this connection must be sustained.

Petitioner paid certain amounts of the sales price to Herbert, his brother. In this connection petitioner argues that Herbert had an interest in the patents and that the amounts paid him constituted payments for such interest. There is no evidence in the record supporting the conclusion that Herbert had a property interest in the patents. Herbert assisted petitioner in his work on the inventions and his advice was invaluable to petitioner. Petitioner paid him a salary as an employee and further paid him a percentage of the royalties but there is nothing to indicate that such percentage was not merely a manner of compensating Herbert for his services in addition to his regular salary. So far as we can determine none of the patents was in Herbert's name nor is there anything in the record to indicate that petitioner had been or was under any legal obligation either to pay Herbert a percentage of the royalties or a percentage of the sales price. The sales contract, it is true, states that the patents subject to the sale are intended to include those, if any, owned by Herbert but this statement is far from proof that Herbert had in fact any interest or that petitioner was obliged to compensate him for any such interest. Under these circumstances we think petitioner has failed to establish the payments to Herbert as [45] either exclusions or deductions from the sales price. It follows that respondent's determination in this connection must also be sustained.

With respect to the question of accelerated amortization petitioner has agreed to abide by respondent's adjustments thereof. In the petition petitioner raised a question concerning the proper amount deductible on account of California franchise taxes. This question was not discussed by either party on brief. Since the determination of this Court with respect to petitioner's liability for Federal income taxes affects the amount of the franchise tax due the State of California the proper amount deductible for such taxes can be determined under a Rule 50 computation.

Decisions will be entered under Rule 50.

[Entered]: Mar. 24, 1947.

[Seal] [46]

[Title of Tax Court and Cause.]

MOTION FOR A REHEARING

Petitioners move the court for a rehearing and as a basis therefor state as follows:

1. The findings of fact are directly contradictory to the evidence. The court, for example, states:

“In 1938 and by the terms of the sales contract Gerrard agreed to pay petitioner certain amounts on account of royalties due up to and including March 31, 1938. These royalty payments were reported by petitioner as income from the business of Harvey Machine Company.”

As Respondent's Exhibit "H" clearly shows, the said royalty payments were reported by petitioner on line 7 of his return for that year and were not reported by him as income from the business of Harvey Machine Co. or as income from any other business; nor does the said return disclose any income of any kind from a business owned by Leo M. Harvey as individual.

2. The court states in its opinion that Lawrence Harvey did not testify at the hearing. Petitioners believe this is prejudicial. The only reason why petitioners did not call him to testify was that petitioners believed and still believe that only the bona fides of the compensation and not the value of the services was involved. In [47] view of the court's consideration of the question of value and its implied rejection of the view that that question is not pertinent in connection with a capital expenditure, petitioners desire now to call Lawrence A. Harvey as a witness for the purpose of showing the value of his services. To this end, petitioners state that if Lawrence A. Harvey is called as a witness, he will testify in substance as shown in the affidavit attached hereto as Exhibit "A".

3. The court, while agreeing that Lawrence Harvey did render services to Leo M. Harvey "in negotiating the sales contract with Gerrard", and while predicating its decision in respect thereto on the question of value, failed to place any value on the said services. Petitioners submit that this is a clear error of law and that it is the duty of this court to determine the value of said services where

in its opinion their value is in issue and the value placed upon them by petitioners was too high.

4. The court has given no consideration as evidence to the payments by Leo M. Harvey to Herbert Harvey of 10% of the \$30,000 annual minimum royalty. Petitioners submit that such payments were clear evidence of an agreement between the parties entitling Herbert to a percentage of the proceeds from the patents, and that the conclusions of the court in respect thereto are in conflict with the evidence. For the purpose only of avoiding any implication that might have resulted from the fact that Herbert Harvey was not called as a witness petitioners now desire to call him as a witness. If Herbert Harvey is called as [48] a witness he will testify in substance as shown in the affidavit attached hereto as Exhibit "B".

Petitioners further pray the court that this motion be not denied without a hearing thereon. Petitioners state in that connection that their counsel will not, because of school engagements, be able to appear in Washington before June 15th.

Wherefore, petitioners pray that this motion be granted.

/s/ GEORGE T. ALTMAN,

Attorney for Petitioners.

215 West 7th Street,

Los Angeles 14, California.

EXHIBIT "A"

AFFIDAVIT

State of Illinois,
County of Cook—ss.

Lawrence A. Harvey, of the County of Los Angeles, State of California, being duly sworn, deposes and says:

1. That this affidavit is made for the purpose of a motion for a rehearing to be filed in Docket Numbers 7116 and 7117 of the Tax Court of the United States.

2. That the term "Petition" used herein refers to both of the petitions filed in the said proceedings before the Tax Court of the United States; and that the term "Petitioners' Exhibit 1" used herein refers to the said exhibit filed in the said proceeding, being a contract under which, among other things, certain patents and patent contracts were sold by Leo M. Harvey, father of affiant, to The Gerrard Company, Inc.

3. That the co-signature of the American Steel & Wire Company on a series of notes (referred to in paragraph 5-A-2 of the Petition and shown on page 21 of Petitioners' Exhibit 1) was entirely due to affiant's efforts; that without said co-signature of the American Steel & Wire Company the said notes would have had very little value; and that except for the 20% of the proceeds of the sale of said patents and patent contracts which was agreed to be paid him by Leo M. Harvey, he received no

compensation of any kind for his efforts; that the said co-signature was obtained by him as a result of voluminous investigation and research by him into phases of contract and [50] anti-trust law and as a result of numerous negotiations with the said American Wire & Steel Company.

4. That Leo M. Harvey called him in to assist him in negotiation with the officials of the United States Steel Company after failing to conclude an agreement with them for the sale of his patent contracts with The Gerrard Company, which company was owned by the said American Steel & Wire Company, a subsidiary of the United States Steel Company.

5. That his father, Leo M. Harvey, was inclined to sacrifice the said contracts for \$300,000 due to his fear that the Gerrard Company, having been acquired by a larger corporation, might abandon the entire invention and stop further payment of the contracts.

6. That the receipt by Leo M. Harvey of an additional \$125,000 in cash and notes was due entirely to affiant's efforts.

/s/ LAWRENCE A. HARVEY.

Subscribed and sworn to before me this 24th day of April, 1947.

[Seal] /s/ A. E. ISAACSON,

Notary Public in and for said
County and State. [51]

EXHIBIT "B"

AFFIDAVIT

State of California,
County of Los Angeles—ss.

Herbert Harvey, of the County of Los Angeles, State of California, deposes and says:

1. That during the years prior to 1930 he spent most of his spare time assisting his brother, Leo M. Harvey, in the invention of certain flat band wire tying machines licensed in 1930 to the Gerrard Company, Inc.

2. That in order to induce him to do this work, which work was done outside of the regular line of trade and business and outside of regular hours of work, Leo M. Harvey agreed to give him 10% of the proceeds resulting from the flat band invention, with the understanding that this said 10% was to be in addition to any compensation he might receive while working for Leo M. Harvey in the machine shop business.

3. That pursuant to the said agreement, Leo M. Harvey paid him each year (beginning in 1930 and ending in 1938) 10% of the royalties received from the said Gerrard Company, Inc., on the said flat band patents.

4. That when the said patents were sold by Leo M. Harvey to the said Gerrard Company, Inc. in 1938, discussion arose between him and Leo M. Harvey with respect to his 10% of the proceeds of sale, which would have been \$42,500; that because

of the large expenses of the sale [52] and other values included in the contract of sale, they settled the amount at \$26,500, \$1,500 to be paid in cash and the balance on the basis of 25/400ths of the payments received from Gerrard on the notes of \$40,000 each.

/s/ HERBERT HARVEY.

Subscribed and sworn to before me this 22nd day of April, 1947.

/s/ WILLIAM S. PEARSON,

Notary Public in and for the
State of California.

My Commission Expires June 30, 1950.

[Endorsed]: Received and filed April 28, 1947.

[Title of Tax Court and Cause]

ORDER

On April 28, 1947, petitioners herein filed a motion for rehearing. As a basis therefor petitioners complained in part of certain findings made by the Court in our Memorandum Findings of Fact and Opinion in the above entitled proceedings entered March 24, 1947. It appearing from such motion that a portion of our findings should be clarified, it is hereby

Ordered: That the Memorandum Findings of Fact and Opinion above mentioned be and hereby is amended by eliminating the sentence on page 4 of

such findings reading, "These royalty payments were reported by petitioner as income from the business of Harvey Machine Company," and substituting in lieu thereof the following: "These royalty payments, received prior to 1938, were reported by petitioner as income from the business of Harvey Machine Company."

It Is Further Ordered: That petitioners' motion for rehearing be and the same is hereby denied.

[Seal] /s/ SAMUEL B. HILL,
Judge.

Washington, D. C. April 29, 1947. [54]

The Tax Court of the United States
Washington

Docket No. 7116

LEO M. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court as set forth in its Memorandum Findings of Fact and Opinion entered March, 1947, the respondent herein filed a recomputation of the tax on May 20, 1947.

At the hearing on respondent's recomputation held July 16, 1947, the petitioner did not appear. No objection has been filed to respondent's recomputation. It appearing that such recomputation is correct, it is therefore, in accordance therewith,

Ordered and Decided: That there are deficiencies in income taxes for the years 1939, 1940 and 1941 in the respective amounts of \$2,277.84 \$4,988.44 and \$7,118.97.

/s/ SAMUEL B. HILL,
Judge.

Entered July 17, 1947. [55]

The Tax Court of the United States
Washington

Docket No. 7117

LENA P. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court as set forth in its Memorandum Findings of Fact and Opinion entered March 24, 1947, the respondent herein filed a recomputation of the tax on May 20, 1947. At the hearing on respondent's recomputa-

tion held July 16, 1947, the petitioner did not appear. No objection has been filed to respondent's recomputation. It appearing that such recomputation is correct it is, therefore, in accordance therewith,

Ordered and Decided: That there are deficiencies in income taxes for the years 1939, 1940 and 1941 in the respective amounts of \$2,277.85, \$4,988.44 and \$7,118.97.

[Seal] /s/ SAMUEL B. HILL
Judge.

Entered July 17, 1947. [56]

[Title of Tax Court and Causes.]

PETITION FOR REVIEW

Leo M. Harvey and Lena P. Harvey, petitioners, by George T. Altman, counsel, hereby file their Petition for Review by the United States Circuit Court of Appeals for the Ninth Circuit of the decisions of the Tax Court of the United States entered on July 17, 1947, and amended July 22, 1947, determining deficiencies in the Federal income taxes of each of the petitioners as follows:

	Leo M. Harvey	Lena P. Harvey
1939	\$2,277.84	\$2,277.85
1940	4,988.44	4,988.44
1941	7,118.97	7,118.97;

and respectfully show:

I.

Jurisdiction

Petitioners are individuals residing at 1750 North Serrano Avenue, Los Angeles, California. The jurisdiction of this Court is invoked under section 1141 of the Internal Revenue Code. [57]

II.

Nature of the Controversy

1. The controversy involves a proper determination of the petitioners' liability for federal income taxes for the calendar years 1939, 1940 and 1941.

2. At all times pertinent to this controversy petitioners have been husband and wife, and residents of the State of California. They filed separate income tax returns, on a community property basis. (Hereinafter the term "petitioner," in the singular, will be used when Leo M. Harvey alone is meant.)

3. In 1929 and 1930 petitioner and the Gerrard Company, Inc. (hereinafter referred to as "Gerrard") entered into five license agreements covering certain patents taken out by petitioner, as well as patents applied for by him, on round wire tying machines and flat wire tying machines. Three of chines and two, flat wire tying machines. Under the ines and two, flat wire tying machines. Under the latter two, one of which covered the United States and the other all foreign countries, petitioner granted to Gerrard the exclusive rights to use and

sell said flat wire tying machines during the entire life of the patents, and Gerrard was required to pay petitioner for such right a minimum total royalty of \$30,000 per year. On or about October 12, 1936, the payment of said royalties was guaranteed by the American Steel and Wire Company of New Jersey, parent company of Gerrard.

4. On or about March 21, 1938 petitioner entered into a contract (hereinafter referred to as the "1938 contract") with Gerrard under which (a) he transferred to Gerrard all of the patents covered in the license agreements mentioned above, the said license agreements being cancelled and terminated; and (b) Gerrard agreed to pay petitioner as consideration a total sum of \$425,000. Of the said total consideration, \$25,000 was payable and paid upon the execution of the contract. [58]

The balance of \$400,000 was payable and paid at the same time by delivery to petitioner of ten negotiable promissory notes in his favor of \$40,000 each, all dated April 2, 1938, and maturing serially, one on April 2, 1939 and one on April 2nd of each year thereafter. The said notes were executed by Gerrard and its parent company, the American Steel and Wire Company of New Jersey, as joint makers. Said notes were tendered and accepted as payment. Those of the said notes which were due in the years involved herein were paid when due. (Hereinafter these notes will be referred to as the "Gerrard notes.")

5. Leo M. Harvey's son, Lawrence A. Harvey, an attorney, negotiated and drafted the entire con-

tract with Gerrard which provided for the consideration referred to of \$425,000. Lawrence was to get 20% of the total proceeds, as paid, as his compensation if a satisfactory deal was worked out; and petitioner paid him his percentage, or \$8,000, in each of the years involved herein.

6. Petitioner had had in his employ for many years his brother, Herbert, to whom he paid a regular salary. In addition petitioner had been paying Herbert 10% of the annual royalty payments of \$30,000 received under the flat band licenses, for Herbert's advice and assistance in connection with development of the flat band patents. Under the 1938 contract petitioner expressly agreed to include "patents, patent applications and inventions, if any, owned by Herbert Harvey and in which either or both Leo M. Harvey and said Herbert Harvey have an interest." Petitioner upon executing the 1938 contract settled with Herbert in respect to his interest for a total of \$26,500, payable \$1,500 immediately and \$2,500 each year thereafter as the payments were received by petitioner on the Gerrard notes. In each of the taxable years involved herein petitioner made said payment to Herbert of \$2,500. [59]

7. In filing their returns for the year 1938, petitioners elected to return their gain from the 1938 contract on the installment basis under Section 44 (b) of the Revenue Act of 1938, but otherwise they filed their returns for the year 1938 on the accrual basis.

8. In each of the taxable years involved herein petitioners reported (half on each one's return) the amount received in such year on the Gerrard notes, less the amounts paid Lawrence and Herbert as aforesaid, as the proceeds of sale of capital assets, under Section 117 of the Internal Revenue Code. The Commissioner, however, treated the amount received as "ordinary income" on each return and also refused any allowance for the amounts paid Lawrence and Herbert. Petitioners thereupon filed their petitions with the Tax Court. The Commissioner in his answers made a general denial, including a denial that petitioner was not holding the patents involved for sale to customers in the ordinary course of his trade or business. Petitioners thereupon (on April 2, 1945) filed a motion for judgment on the pleadings on the ground that said denial by the Commissioner necessarily, although indirectly, included a contention that petitioners should have reported the entire \$425,000 in 1938 and no part of it in the taxable years herein involved. The Tax Court denied the motion and the case eventually went to trial. After trial the Tax Court filed its opinion sustaining the Commissioner. Subsequently, on April 28, 1947, petitioners filed a motion for rehearing. The Tax Court denied the motion but in partial response to it amended its opinion. Subsequently, on July 17, 1947, the Tax Court entered its decisions, and on July 22, 1947, entered certain amendments thereto. In that state the proceeding comes before this Court. [60]

III.

Assignments of Error

Petitioners assign as error the following acts or omissions of the Tax Court:

1. Denial of motion for judgment on the pleadings.

2. Failure to hold that the amount received each year on the Gerrard notes was an amount received on the sale of "capital assets" as that term is defined in Section 117 (a) (1) of the Internal Revenue Code.

3. Failure to make any determination of the holding period of the property sold under Section 117(h) of the Internal Revenue Code.

4. Failure to determine that the holding period of the property sold was more than two years.

5. Failure to allow either as offsets or deductions the amounts paid Lawrence A. Harvey and Herbert Harvey, or any portion thereof.

6. Finding of deficiencies for the years involved instead of overpayments as requested.

/s/ GEORGE T. ALTMAN,

Counsel for Petitioners.

State of California

County of Los Angeles—ss.

George T. Altman, being first duly sworn, says that he is counsel of record in the above-named causes; that as such counsel he is authorized to verify the foregoing petition for review; that he has read the said petition and is familiar with the statements contained therein; and that the statements

made are true to the best of his knowledge, information and belief.

/s/ GEORGE T. ALTMAN.

Subscribed and sworn to before me this 14th day of October, 1947.

[Seal] /s/ VICTOR BEHRSTOCK,
Notary Public in and for said
County and State.

[Endorsed]: Received and filed Oct. 17, 1947.

The Tax Court of the United States

Docket No. 7116

LEO M. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 7117

LENA P. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Los Angeles, California.

November 8, 1946—10:10 a.m.

(Met pursuant to notice.)

Before: Honorable Samuel B. Hill,
Judge.

Appearances:

George T. Altman, 215 West Seventh Street, Los Angeles, California, appearing for Petitioners.

E. A. Tonjes: (Honorable J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue), appearing for the Respondent. [65]

PROCEEDINGS

The Court: Announce your appearance first, please.

Mr. Altman: George T. Altman for the Petitioners.

Mr. Tonjes: E. A. Tonjes for the Respondent.

* * * * *

The Court: Mr. Tonjes, do you desire to make a statement?

OPENING STATEMENT ON BEHALF
OF RESPONDENTS

By Mr. Tonjes

Mr. Tonjes: Very briefly, your Honor. I think Mr. Altman has probably anticipated what my position is. I just want to state that the notice of deficiency issued by [71] the Respondent contends that the \$40,000.00 received by the taxpayer in each one of the years here in controversy was income and taxable, and he stated that no other persons had any interest in the sums received, and that therefore there is no deduction or elimination to be made of that \$40,000.00 sum, and further that the assets sold were not the sale of a capital asset.

Of course, it was an asset held by the Petitioners primarily for sale in the ordinary course of the trade or business, and I might say the property sold was property used in the trade or business and of a character which is subject to allowance for depreciation, and therefore was excludable from capital gain.

The Court: Call your witness.

Whereupon,

LEO M. HARVEY

called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please.

The Witness: My name is Leo M. Harvey, 1750 North Serrano Street, Los Angeles.

Direct Examination

By Mr. Altman:

Q. Mr. Harvey, you are, are you not, the Petitioner, or rather one of the Petitioners in these proceedings? A. Yes, sir. [72]

* * * * * *

By Mr. Altman:

* * * * * *

Q. Will you state exactly what this document is, Mr. Harvey? I should like at this time to introduce that as Petitioners' Exhibit 1.

(The document above-referred to was marked Petitioners' Exhibit No. 1 for identification.)

(Testimony of Leo M. Harvey.)

A. This is a document that describes the sale of the patents to the Gerrard Company on the 21st day of March, 1938, in addition to other matters involved in this transaction. [73]

* * * * *

Q. (By Mr. Altman): Mr. Harvey, will you state to the Court just how that transaction arose?

A. Well, sometime in 1938, while I was in Chicago, I met an attorney by the name of Walter Sheldon. He is attorney for the steel company, that is the U. S. Steel Company, and American Wire and Steel Company. I talked to him and we discussed the matter of branching out into larger business, and I told him I haven't got any money, so he says to me, "Why don't you sell your patents to Gerrard Company which you have?" The Gerrard Company at that time paid us a royalty under those patents. I says we might work out a deal, if we can do it then we will have some capital assets and we can enlarge our business. He says, "I tell you what to do, you have a son an attorney, get him out here and we will go down to Cleveland to see the American Steel and Wire Company, then we will go to Pittsburgh to see if we can make a deal." So I phoned Lawrence Harvey, my son, and he came out to Chicago and then we went to Cleveland and then to Pittsburgh and went back to [74] Cleveland four or five times and discussed the matter, and finally the outcome of that was this transaction that we just concluded, this document which just has been presented to the Court.

(Testimony of Leo M. Harvey.)

Q. Yes. Pardon me. May I have it? I want to refer to it. What different classes of patents were involved in this transaction?

A. There were two classes of patents involved in the transaction. One was the flat band patents and one was the round wire patents.

Q. Did the flat band patents have any relation in any respect to the round wire patents?

A. None, because they are an entirely different art.

Q. Will you explain to the Court just what difference there is between them, between the round wire and flat wire patents?

A. Well, a flat wire—I mean a round wire is a piece of round wire that you put on a box, and it is fixed on an angle to hold it together so it would not come apart. The flat band is a binder which is put around the box and it has to be crimped in an entirely different manner, it is not twisted like a round wire, or either put a seal on it to hold it together. That is the difference between the two.

Q. There is no connection between the two insofar as method of application? [75] A. No.

Mr. Tonjes: Mr. Altman, please don't lead him so much.

Q. (By Mr. Altman): With respect to the round wire patents, Mr. Harvey, were you the owner of those patents referred to in this transaction?

A. No, certain patents we owned and certain patents they owned. Originally they owned——

The Court: Who were they?

(Testimony of Leo M. Harvey.)

The Witness: That is the Gerrard Company. Originally we started to make the round wire machine for the Gerrard Company. They owned the patents and we had an agreement to manufacture for them, and while they were making these things, after that occasionally when there was a patent involved we put them in the group of patents that was belonging to the round wire patents.

Q. (By Mr. Altman): What is your opinion of the value of these round wire patents, or rather a right for the use of those round wire patents, at the time of this transaction?

A. Well, we determined the value, we discussed the matter with an attorney by the name of Beye of the U. S. Steel Company, but U. S. Steel has the sole ownership of the American Wire and Steel Company which in turn owned the [76] Gerrard Company, and we placed the value on the patents for flat band of \$400,000.00, and that was based on the amount of minimum royalty we received from Gerrard Company, which was \$15,000.00 a year for the domestic flat band patents and \$15,000.00 a year for the foreign flat band patents.

Mr. Tonjes: Was the question related to the flat band or the round wire patent?

Mr. Altman: My original question related to round wire.

The Witness: I am explaining——

Mr. Altman: Maybe the witness is trying to arrive at that in some manner.

Mr. Tonjes: All right.

(Testimony of Leo M. Harvey.)

The Witness: Then a certain sum of money in addition to the \$400,000.00 was paid to us——

Mr. Tonjes: I object to the witness testifying in this manner, your Honor. The question was what, in his opinion, was the value. I think his answer should be limited to that.

The Court: Yes, you were asked what, in your opinion, was the value of these round wire patents. You may give your opinion and any explanation you want as to how you arrived at your opinion.

Q. (By Mr. Altman): Restricting yourself to the round wire. [77] A. Round wire?

Q. Yes.

A. Well, I don't remember the exact amount, but the amount of the round wire patents is stated in the contract.

Q. I didn't know that they were.

A. Yes, they are.

Q. Let me ask you this: Was any part of the consideration of the \$425,000.00 recited in this contract intended to cover the round wire patents or had reference to the round wire patents?

Mr. Tonjes: I object to that, your Honor, unless there is some ambiguity in the contract which calls for this witness to explain it, if there is anything in here which indicates that there is segregation or lack of segregation or something of that sort. Up to the present time there is no reason for that question.

Mr. Altman: Your Honor, I am sure counsel has a copy of this contract, and in the paragraph

(Testimony of Leo M. Harvey.)

which refers to the \$425,000.00 there is no statement as to what it covers, what it is intended to cover, despite the fact that in other paragraphs other amounts are named for other properties.

The Court: You may answer.

The Witness: As far as I recollect, the total amount of money paid, that is in the lump sum of \$400,000.00 or \$425,000.00, there was no round wire included, and it was [78] paid for the flat band.

Q. (By Mr. Altman): What factors give the flat band patents that value of \$425,000.00?

A. On the amount of royalty I was to receive from Gerrard Company yearly, that is the minimum royalty.

Q. Have you ever received any amount of royalty from the Gerrard Company over and above the minimum royalty which you have referred to?

Mr. Tonjes: I object to that as not being the best evidence, your Honor. I think it should first be established as to what patents he had, and to whom he had assigned any rights under them, and then the testimony as to what he received for each. I don't think that the questions are fairly propounded.

Q. (By Mr. Altman): Mr. Harvey, I will refer you to the schedules of patents in this Exhibit A—I mean Exhibit 1. This purports to be a list of the patents, under Group A, entitled Patents and Applications for Patent Related to Round Wire. There is another list in another group B, Patents and

(Testimony of Leo M. Harvey.)

Applications for Patents Related to Flat Wire or Band.

Are these the two groups respectively, Mr. Harvey, which were transferred to the Gerrard Company? A. Yes, sir. [79]

Q. Referring again to this Schedule or Group B, Patents and Applications for Patents Related to Flat Wire or Band—if your Honor please, there are two full pages of patent numbers—were these the flat band patents which you referred to in your prior testimony? A. Yes, sir.

Q. Were these the flat band patents on which you received royalty?

A. That is right, yes, sir.

Q. Now, I should like to repeat my former question with respect to those royalties. Did you ever receive any amounts on these patents other than the minimum royalties? A. No, sir.

Mr. Tonjes: May I ask the witness a question at this time?

The Court: Yes.

Mr. Tonjes: Do you have a written contract with any company leasing or giving them a right to operate under your round wire patents?

The Witness: No, sir.

Mr. Tonjes: Do you have any contracts of any kind with any other person?

The Witness: No other person.

Mr. Tonjes: All right, proceed. [80]

Q. (By Mr. Altman): Will you state somewhat more fully, Mr. Harvey, just what services were

(Testimony of Leo M. Harvey.)

rendered by your son Lawrence A. Harvey in connection with this transaction in 1938?

A. Well, he organized the whole deal. He is an attorney. He knew how to handle the matter, and I relied on him to have the discussion with the attorneys from the U. S. Steel Company, because they came into the picture because they owned the American Wire and Steel and the American Wire and Steel owned the Gerrard Company, and he also investigated with reference to selling these patents, with respect to the income tax situation. I had him make the arrangements, and he made all the arrangements.

Mr. Tonjes: I move to strike the witness's answer out, your Honor, as being entirely irrelevant and immaterial and not responsive to the question. We have no question here as to the reasonableness of any compensation paid to Lawrence Harvey. We want to know whether he had any interest in the patents.

The Court: Well, the answer is responsive, but I don't know whether it is material or not.

Mr. Altman: Your Honor, that point is in issue under the pleadings, and respondent has never denied that the—while Respondent denied the allegations of the petition in that respect, this is their first attempt to say [81] that the point is immaterial. At the outset, if you will recall, your Honor, we stated that the question would be with respect to these payments, whether they were excluded or that is, treated as offsets in that respect—

(Testimony of Leo M. Harvey.)

The Court: That is a royalty, and not compensation for Lawrence.

Mr. Altman: Lawrence Harvey.

The Court: Any compensation which you claim should be either excluded or deducted from the total amount received?

Mr. Altman: That is right, your Honor. Now, if they are a deduction and not exclusions, then the question is I would like to know as to what those services were and what was their value. If they are mere exclusions, then as I understand the point made by the Respondent here, the question would be as to what rights Lawrence Harvey had in those patents.

Mr. Tonjes: I think that might help your Honor, and I think that is true.

The Court: All right, go ahead.

Q. (By Mr. Altman): Mr. Harvey, when you called your son Lawrence out to the east in connection with this transaction, did you advise him before he started that you would compensate him for his services? A. Yes, I did. [82]

Q. Did you make any agreement with him, any definite agreement with him as to what compensation he would get?

A. Yes, we did. If the transaction was made it was understood that he will get 20 per cent of the \$400,000.00 that I am to receive at the rate of \$40,000.00 a year, and he gets 20 per cent of that each year, and he gets his money.

Q. That was your understanding?

(Testimony of Leo M. Harvey.)

A. That is right.

The Court: 20 per cent of the amount you were to receive for the patents?

The Witness: For the \$400,000.00.

The Court: You say \$400,000.00. It is not that exactly, is it?

Mr. Altman: It is \$425,000.00, your Honor.

The Court: All right.

Q. (By Mr. Altman): Would you say that Lawrence Harvey's accomplishments in connection with this transaction were worth that amount of compensation?

A. Yes, they were, because it was very major possibility unless I got some ready cash, be able to sell something so that we can go ahead in a larger business, which we did not have at that time.

Q. And he handled the transaction safely?

A. Yes, sir. [83]

Mr. Altman: In regard to this contract with Lawrence Harvey, your Honor, I had planned to bring up here the written contract between Leo M. Harvey and Lawrence Harvey, which was executed shortly after the transaction, but apparently it has not yet arrived. Some one was sent for it. I should like to complete that.

Q. (By Mr. Altman): Did you execute a written contract? A. Yes, sir, I did.

Q. With Lawrence Harvey?

A. That is right. [84]

* * * * *

(Testimony of Leo M. Harvey.)

Q. (By Mr. Altman): Mr. Harvey, referring again to this Exhibit 1, there are several references in here to Herbert Harvey. Who is Herbert Harvey? A. Herbert Harvey is my brother.

Q. Will you state what services were rendered by Herbert Harvey in this connection, in connection with these various patents?

A. Originally with me he helped and advised with [85] reference to the original, I would say working out of the flat band patents.

Q. Did you pay him any part of the royalties as you received them? A. Yes, I did.

Q. What portion?

A. I believe it was 10 per cent, 8 or 10, I don't remember exactly, but I paid him each month I received my royalty, he got his.

Q. Mr. Harvey, did he have any interest or rights in these patents of record?

A. I believe he had some patent which is marked Herbert Harvey patent in that agreement that you just showed to me.

Q. Referring to the amount of \$2500.00 per year which you paid Herbert Harvey out of the \$40,000.00 per year received from Gerrard, what was that compensation for?

A. That was given to him in lieu of the former royalty he was getting from the flat band patents, and when we made a settlement for the flat band patents under this agreement I arranged that he will get his prorata share each time we received the

(Testimony of Leo M. Harvey.)

\$40,000.00, he got a statement of \$2500.00 each time, and he received this, that is his share.

The Court: This \$400,000.00, was that composed of separate payments?

The Witness: That is right. [86]

Mr. Altman: That was the gross amount, if your Honor please, received by him, the contract totalling \$425,000.00 and it was paid in this way, \$25,000.00 was paid in cash on the execution of this contract in March of 1938. In additional to the cash of \$25,000.00 there was given to Mr. Harvey 10 \$40,000.00 notes.

The Court: That was in payment of the purchase price?

Mr. Altman: Well, it was in payment of this total of \$400,000.00 which we stipulated at the beginning of this session was received.

The Court: Talking about the \$40,000.00 royalty then, in other words, as to whether it is royalty or a payment on the purchase price.

The Witness: Well, this was part of the purchase price and it is actual payment on this price the same as the amount of \$25,000.00 which I received.

Q. (By Mr. Altman): Mr. Harvey, could you have made this contract of sale to the Gerrard at all, could you have completed this transaction at all without making a separate settlement with Herbert Harvey?

Mr. Tonjes: I object to the question. It calls

(Testimony of Leo M. Harvey.)

for a conclusion, and there has been no foundation laid for the question. [87]

The Court: I suppose it would involve the question whether Mr. Harvey owned an interest in the patents and had a voice in whether or not they should be sold.

Q. (By Mr. Altman): Mr. Harvey, did Herbert Harvey have any right or interest in these patents?

Mr. Tonjes: I object to that, your Honor, as also calling for a conclusion. If there was any right he can tell what it was.

The Court: It might call for a legal conclusion as to the title. First, will you state more fully the facts here leading up to the proposition, whether or not Herbert Harvey did have any right or interest in connection with the title to these patents.

Mr. Altman: Your Honor, if counsel will refer to this Exhibit 1, he will see that under the contract Leo Harvey was required to make any settlement with Herbert Harvey as a part and parcel of this contract.

Mr. Tonjes: If your Honor please, I am well aware of that provision there, and it is to the effect that Herbert Harvey does make some disposition of his interest in the patents, if any. I am not prepared to admit that he had any interest in them, your Honor.

The Court: Well, he has testified now that Herbert did some work in connection with the develop-

(Testimony of Leo M. Harvey.)

ing of some of [88] these patents, as I understand. Is that correct?

The Witness: Yes, sir.

Mr. Tonjes: I don't think that is sufficient to give him any interest in the patents. I don't know the particular interest. Just because he did a little work on them—was he employed by you regularly, Herbert Harvey?

The Witness: Yes, sir.

Mr. Tonjes: I could not possibly admit that, your Honor.

The Court: Well——

Q. (By Mr. Altman): I will ask again, Mr. Harvey, was there any agreement between you and Herbert Harvey prior to the date of this transaction, any oral agreement prior to the date of this transaction, in which you recognized that he had by virtue of his work and his research an interest in these patents?

A. Well, it was a question of probably advice that he gave from time to time, and when that agreement was made that I should receive a royalty, I agreed with him that I would give him 10 per cent of the royalty I received, and I paid him each month as we received the royalty.

The Court: Let's see, is that royalty or payment on the purchase price?

Mr. Altman: That is right, your Honor.

The Witness: Well, when we sold the patents to the [89] Gerrard Company we were to receive four hundred odd thousand dollars. We then gave Her-

(Testimony of Leo M. Harvey.)

bert part of his interest in that, we will pay him \$25,000.00 each year as we receive——

The Court: \$2500.00.

The Witness: \$2500.00, and each year as I received the \$40,000.00 yearly, and it was to continue for the next 10 years, and I paid him all of that money.

Q. (By Mr. Altman): Mr. Harvey, other than this transaction referred to in Exhibit 1 here, have you ever sold any patents?

A. No, not to my knowledge.

Q. Have you ever offered any for sale?

A. No, not to my knowledge.

Q. Did you ever hold any patents for the purpose of selling them?

A. We don't have a business of developing patents. Patents are developed occasionally when you come across—our business is the machine shop business, and occasionally we will come across some patent, developed and the application is filed for it, but we do not do it as a regular business practice.

Q. You never offered any for sale?

A. Not to my knowledge, no.

Q. What is the nature of that machine shop business you speak of? [90]

A. We make tools, dies, models, machine work for novelties for different customers.

Q. If any inventor brought in some diagram, would you co-operate with him and try to build a machine from his diagram? A. Yes, sir.

(Testimony of Leo M. Harvey.)

Q. Do you also manufacture any items for sale?

A. What period do you refer to?

Q. I am referring to the period up to and including March 1938, let us take, for example, the last 10 years prior to that date.

A. No, I don't remember selling or offering an article for sale, that is directly by our firm. It is mostly a jobbing shop, and we do job shop work for other people.

Q. Referring now to these flat band patents, did you ever manufacture any machines under those patents?

A. Yes, we did, we made the first few machines for the Gerrard Company, but we never made any more.

Q. You mean you made sort of models, the first finished models, did you? A. Yes.

Q. When was that?

A. I don't know exactly offhand. We just made the first and never made any more.

Q. About when was that? [91]

A. Sometime in 1930 or 1931.

Q. After the time when you turned those models over to Gerrard, did you do any further work in connection with these flat band patents?

A. As far as my recollection is concerned, when we agreed with Gerrard with reference to the flat band we agreed to finish a certain amount of work that we had started, and the agreement was made on certain small things that have been made, I don't know how many, but not very many after that.

(Testimony of Leo M. Harvey.)

Q. Are you referring to completion of patents?

A. That is right.

Q. That is applications that were then pending?

A. Yes, sir.

Q. Referring to the last two years or the last two and a half years prior to the date of this transaction, did you do any work of any kind in connection with these flat band patents?

A. Not to my knowledge.

Mr. Tonjes: Would you kindly read that last question to me, Mr. Reporter?

(The record was read.)

Q. (By Mr. Altman): I will ask you again if those flat band patents have any relation to the business in which you are engaged including the round wire patents? [92]

A. I don't understand the question.

Q. Were these flat band patents in any way pertinent to or necessary to or were they in some way involved in the business which you were carrying on in the last two or three years or so prior to that transaction?

A. We never used the patent because we never made the machines.

Q. Referring to the wire machine or wire tying trade, are round wire and flat wire or slot band wholly different fields of production?

A. Yes, they are.

Q. In connection with the completion of various patents which you referred to back in the early years, who paid the expenses, you or Gerrard?

(Testimony of Leo M. Harvey.)

A. They were paid by Gerrard Company, and as far as I recollect we have two contracts, one for foreign and one for domestic. For the foreign patents Gerrard Company paid all the patent expenses.

Mr. Tonjes: That is both round and flat wire?

The Witness: No, we are talking about flat wire only.

Mr. Tonjes: Flat wire?

The Witness: We call it flat band.

Q. (By Mr. Altman): Would you say that with respect to the flat band [93] Gerrard paid all the expenses? A. That is right.

* * * * *

Q. (By Mr. Altman): Mr. Harvey, were you ever in the installment business? That is, did you ever regularly sell any property on the installment plan? A. No, sir.

* * * * *

Cross-Examination

By Mr. Tonjes:

Q. Mr. Harvey, when did you first start in business? A. About 1913 or '14, if I recollect.

Q. What business were you in then?

A. In the machine shop business.

Q. In Los Angeles here?

A. That is right.

Q. And were you engaged in making any particular article or making articles on special order, such as you have indicated?

(Testimony of Leo M. Harvey.)

A. Making articles on special orders.

Q. Let me ask you this first: Did you have any special training, technical training or take college degrees or something of that sort in mechanical engineering

A. No college degrees, no, I have not.

Q. Did you have any special training in mechanics? A. Yes, I did.

Q. Will you state what that was? [95]

A. I went to Cooper Union in New York. I studied at night correspondence courses. That is about all the training I had.

Q. How long did you go to Cooper Union?

A. I don't recollect. Not very long. I left New York in 1910.

Q. Maybe three or four years, did you go?

A. Oh, no, not that long, maybe two night courses, something like that.

Q. Did you go to high school?

A. No, I went to preparatory school in the evening because I worked in the day time all the time.

Q. And you never went to college?

A. No, sir.

Q. How long did you take those correspondence courses?

A. I don't remember. I don't recollect.

Q. Just approximately a year or two, would you say? A. Yes, something like that.

Q. And they were all along mechanical lines, were they? A. Yes, sir. [96]

Q. And when did you first begin devoting your

(Testimony of Leo M. Harvey.)

time to development of ideas, what might be patentable?

A. Well, you don't devote your time, they come, sometimes they may come often, sometimes they may not come for years, come along an idea and you don't specialize in—or you could not specialize I would say, as far as I am concerned, I could not specialize in working on ideas only.

Q. No, but probably you can go back—you get an idea, then it takes a little time for you to develop the idea doesn't it? A. Yes it does. [97]

* * * * *

Q. Well, when did you first get the idea of the wire tying devices? [98]

A. Well, there are two phases of wire tying devices.

Q. No, I mean the first wire tying device of any character.

A. Of any character, that would be the first patent that we filed. I would imagine sometime in 1925, could be 1924, just somewhere about that, in the middle twenties.

Q. That was the first time that you ever gave much serious thought to developing a wire tying device?

A. Well, I say that because I believe there is a patent somewheres in the middle of the twenties.

Q. Would it help you any to make a reference to the contract? Primarily, I want your own recol-

(Testimony of Leo M. Harvey.)

lections, although if you can get anything out of there that will help you, you may refer to it. [99]

* * * * *

Q. (By Mr. Tonjes): How long did you have to work on that before it ripened into a patent?

A. Well, that is —I can not answer exactly, because I don't know the exact time, see?

Q. Would you say maybe two years, three years?

A. Sometimes you get an idea and it may ripen in a week and sometimes it may ripen in ten years.

Q. Let me ask you this question directly: Can you tell me now after looking at that contract the first time you had an idea of developing a wire tying device?

A. As far as I can see and hear, that was before 1927, somewheres close to that.

Q. Before 1927? A. Yes.

Q. From your own personal recollections, can you tell me about how much it was before 1927? Would you say five years or three years?

A. Well I am trying to give you the correct answer on this. It is impossible.

Q. I appreciate that Mr. Harvey. It is going back a long ways, and it is rather difficult.

A. Maybe a year, maybe two, I don't remember exactly. [100]

Q. Now, would you say that that was the first idea you devoted any time to with the idea of developing it? A. A wire tying machine?

Q. Yes.

A. No, no, because in 1921 we manufactured

(Testimony of Leo M. Harvey.)

wire tying machines for a concern that already had the patents, and of course we made machines for them, and I don't know whether you would consider that making ideas or not.

Q. Yes. I mean some other idea besides wire tying devices. Did you work on anything or attempt to develop anything prior to 1927? You already have told me about the salt cellar. Was there some other besides that?

A. Not that I remember.

Q. When you first started developing these ideas, did you make some models, some smaller models or something of that sort to experiment with?

A. Yes, we do.

Q. And you also make many drawings, I suppose.

A. Yes, we make drawings.

Q. And you have in mind the ultimate idea of developing a patentable method, that is the general idea, isn't it?

A. Well, you don't work at it that way. You don't know whether you can get a patent or not. You just get the idea, you see.

Q. What do you hope to do with the idea? [101]

A. Well, the object, we were in the machine shop business, we always wanted to make articles for ourselves and sell them ourselves.

Q. And you wanted to sell the article yourself if it could be produced under some patent which you developed. Did you answer that last question?

A. What did you ask me?

(Testimony of Leo M. Harvey.)

Mr. Tonjes: Will you read the question Mr. Reporter?

(The question was read.)

The Witness: Well, it was not the idea that it has to be patentable. It has to be something good.

Q. (By Mr. Tonjes): Oh yes.

A. Because the patent is incidental, you see. Of course we always consider ourselves, we figure the patent is a license to fight, and it is the article that is the most important thing.

Q. Why would you want to have that license?

A. Well, sometimes we think it may help us prevent others making the same thing.

Q. And that could be taken out for three reasons, it would give you the right to manufacture something exclusively, and you could either manufacture under your right or you could sell the right or you could lease out the right, and [102] was it for the purpose of engaging in any one or all of these activities that you devoted your time and effort to inventing things?

A. Well, inventions don't come that way, you have got to understand you don't work on a thing because you are going to do it, it comes to you because you think of it and you make it.

Q. Alright, why do you make it?

A. Well, at the beginning you make it because you like the particular article, you like to do that work. I like to make up gadgets more than I like to eat, otherwise you don't do these things, and un-

(Testimony of Leo M. Harvey.)

less the engineer likes his trade he don't develop nothing.

Q. Why do you go to the trouble of having it patented?

A. As I explained to you, because I hope that will help us in making the article, nobody else will encroach on you.

Q. In other words, it will give you an exclusive right.

A. Yes.

Q. Why do you want that exclusive right?

A. Probably to help us, as I told you, help us in our business, maybe.

Q. How would it help you? You mean you wish to sell it?

A. No, you can sell the article.

Q. Sell the patent itself?

A. No, the article, sell the article, not the patent.

Q. I ask you if you would get the patent because you would have the right to sell the patent itself, is that one of the things?

A. Well, anytime you—anything you have you might want to sell, but that was not the primary reason. The primary reason was to develop the idea that comes to you first of all because you like to do things. Second, it doesn't come to you because you set out to think about it, it comes to you incidentally mostly, and then you think it over and you take it and you think around and try to make it go, and I consider if you have a patent you have probably a better chance if you want to make the article that nobody will encroach on you.

(Testimony of Leo M. Harvey.)

Q. And you consider it to be a valuable right, do you not?

A. Yes, I do. Then first let me qualify that. As I already said before I do because we ourselves consider the license, the patent only a license to fight, because we understand primarily when you get the patent allowed by the Patent Office, it is only saying they look over all the art and they found no conflict, but it don't give you any rights except the right you get after you go to court.

Q. Yes, but you also I suppose appreciated at that time, that a good patent would produce considerable royalty if you cared to leave it out?

A. Yes, sure, we though that too.

Q. And that of course no doubt prompted you in your efforts to develop something patentable, did it not?

A. I would say it might have, but it was not the primary reason for doing the thing. Well I suppose you invented something in your life, and you know how those things go, you do it because you like to do it. There is a lot of things that never got to be patented, because I like to do it.

Q. But you would be much more satisfied if you came out with something good, wouldn't you?

A. Yes, we have to live, otherwise we can't exist.

Q. Now, during the time that you were engaged in developing ideas—well, let me ask you this first, Mr. Harvey: How many patents did you take out in the various years, how many patents were

(Testimony of Leo M. Harvey.)

granted you in the various years? Have you any idea? A. No, I can't tell you.

Q. Do you have any idea how many you have altogether?

A. I can't do that, because we have a number of patents in the list of patents that are foreign country patents which is a copy of the American patent, they are really not a new patent, they are a copy of the American patent. [105]

Q. Leaving out the foreign patents, how many American patents were granted to you on various articles, not only the wiring devices, but on patents generally, how many patents were granted to you?

A. Oh I would say, that is the article itself—you see, the Patent, sometimes the Patent Office asks you to divide your application in part by arts. In other words, you file an application, the Patent Office says, it involves more than one art and it says you divide it up into four or five different patents, and in spite of filing the one patent maybe you will have five patents issued by the United States Government, see?

Q. Yes.

A. And they really pertain to the same thing, so the number of patents involved is not of great importance, so far as our line of work. It is the article that you make.

Q. Well, let me ask you this; how many articles do you have patents on?

A. Well, let's see, three or four maybe five.

(Testimony of Leo M. Harvey.)

Q. Can you tell me what they were? We have flat and round wire tying devices. We have those.

A. You got two. I developed then a patent on a paper dispenser.

Q. What kind of a paper dispenser?

A. Paper towels. I don't recollect any more now. [106]

Q. On washing machines?

A. Washing machines, yes, part of a washing machine. It is not exactly all of a washing machine.

Q. Do you know when you devoted some time to developing a washing machine?

A. Well, yes, the washing machine we started I think in 1939 or 1938, if I recollect correctly.

Q. You mean that is when you got the first patent or that is the time you first started in toying with the idea of developing some part of a washing machine?

A. That was the first time. I don't remember exactly whether it was 1939 or 1938.

Q. Did you develop any spraying devices?

A. Spraying devices? I couldn't recollect. I can't remember. It could be a patent I applied for, or articles involved.

Q. Any agricultural machinery of any kind?

A. Yes we had a patent on a—I think a clipper for cutting oranges.

Q. Cutting what, oranges?

A. Cutting oranges, yes.

Q. And that is about five different devices, five different kinds?

A. Maybe there were more.

(Testimony of Leo M. Harvey.)

Q. They resulted in patents being granted, is that [107] correct? A. Yes.

Q. Would you say that all of the devices to which you gave some thought resulted in a patent being granted? A. No, no.

Q. Can you tell me approximately how many subjects you devoted some thought to with the idea of getting a patent?

A. No, I couldn't, that is too far to remember.

Q. You would say there would be quite a few though, wouldn't there?

A. There would be some, yes.

Q. Now, in connection with the development of a patent, you would oftentimes incur some expenses? A. You do.

Q. Do you know how you treated those expenses on your books and for your income tax purposes?

A. Well, no, I don't. I have a recollection of it, but I do not make out the income tax blanks. That is made out by somebody who knows the business, and I ask him if that is correct and he says yes and I sign it. I look at it and he says it is all right.

Mr. Tonjes: Mr. Altman—this is off the record, if your Honor please.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

Mr. Tonjes: The parties stipulate that the expenses [108] incurred by the Petitioner in connec-

(Testimony of Leo M. Harvey.)

tion with his development of the several patents were deducted on his income tax return.

Mr. Altman: Yes, I will agree to that.

Q. (By Mr. Tonjes): Do you recall, Mr. Harvey whether or not in your books of account you kept or made any segregation with regard to the expense incurred by you in the development of these several patents?

A. I think they were. I don't know for sure, but I think they were.

Q. That is to say, if an expense of \$500.00 we will say, was incurred in connection with the round wire patents, that was charged to round wire patent expense, and if a similar expense was incurred for a flat wire or flat band development expense, it would be charged to development of that flat band?

A. I don't know exactly. I can't answer that, because on the books it would not so show, because every job had a number and it says number so and so was charged with so much money.

Q. When did you first give some third person or corporation a right to operate under a patent held by you?

A. The first time I gave a right, your question is the first time we gave a right under the patent that I owned to another individual to operate under the patent? Is that what [109] you asked?

Q. That is correct.

A. To the best of my recollection it is the Ger-

(Testimony of Leo M. Harvey.)

rard Company was the first time we had a license agreement on a patent.

Q. The Gerrard Company. Do you recall what patents were covered by that agreement?

A. That was to cover the flat band patent.

Q. And what year was that?

A. 1930.

Q. In 1930 you gave the Gerrard Company the right to operate under the flat band patent?

A. That is right.

Q. Did it provide for a royalty?

A. Yes, it did.

Q. Do you know how much?

A. Yes, a minimum royalty of \$15,000 a year.

Q. \$15,000 a year, and that was paid to you every year beginning in 1930 right on through all of the later years until the date of the sale?

A. Yes.

Q. Did you have any other patent on which you received a similar royalty?

A. Yes, royalty on the flat band patent, on which we received similar royalty. That was based on 5% of the sale [110] of bands that they used in the machine, providing for a minimum charge of not less than \$15,000 a year, yes, I think \$15,000 a year in the domestic patent and \$15,000 a year on the foreign patent.

Q. And you received that \$30,000 a year each year after 1930. A. I think so, yes sir.

Q. And you reported that as income from your business? A. I think as far as I recollect.

(Testimony of Leo M. Harvey.)

Q. Did you give any of it to Herbert Harvey?

A. Yes I did.

Q. Beginning when, in 1930?

A. Beginning the first time I got the royalty he received his, some of the money.

Q. How much did he get?

A. As far as I know it was \$150.00 under each group of patents. That is my recollection.

Q. What was that, \$150.00 a month or a year?

A. A month.

Q. Did Lawrence Harvey get any money?

A. No.

Q. Why did you give the money to Herbert Harvey?

A. Because I considered his advice very valuable. It is not what you do in the daytime in the business, it is what you do in the evening and Sunday and holidays in discussing [111] these matters and advising, I considered was valuable to me.

Q. Was there any agreement that he would get a certain percentage of these inventions?

A. No, there wasn't any written agreement.

Q. Was he on your payroll in other respects?

A. Yes he was.

Q. When did he first enter your employ?

A. Way back in 19— oh, I don't remember, 1918, something like that. I don't remember exactly.

Q. And he was in your employ continuously over a period of years of the development of these ideas?

A. Yes, sir.

(Testimony of Leo M. Harvey.)

Q. Do you recall what salary you paid him?

A. Well, at different times different salary. I think he was getting \$500.00 a month and at a certain time he was getting I think as high as \$1,500.00 a month.

Q. You say the flat wire patent devices were the first patents on which you received any royalties?

A. Yes.

Q. And that was in 1930 and ran through 1938 when the patents were sold? A. Right.

Q. Were the rights under the round wire patents ever given to anybody? A. Yes. [112]

Q. To whom were they given?

A. Certain rights were given not on the royalty basis though. Gerrard had also—you see, they had made the round wire machine also for the Gerrard Company, and they didn't receive a royalty on them.

Q. Did you arrange the right to operate on the round wire patents for the Gerrard Company?

A. Certain patents we did, yes.

Q. Not all of them?

A. Not all of them.

Q. When was that arrangement made?

A. It was before 1929.

Q. Before 1929? A. That is right.

Q. And let me ask you this question: When did you get your first right under the round wire patents? When did you get your first round wire patent, do you recall? A. No, I don't.

(Testimony of Leo M. Harvey.)

Q. Could you refer to that agreement? Would that help you?

A. Yes, after the sale has been made. Well, the first patent in here is a foreign patent we had in France in 1927 on the round wire machine, but that patent is an outgrowth of the United States patent, which was issued at a later date, and as far as I recollect any patent that was sold, I would say giving them rights, was sometime in 1929.

Q. And did you continue to work on the round wire device after you entered into this agreement with the Gerrard Company?

A. Well, as I explained before, the idea is incidental to your working on the thing, and I can not say exactly when I did work on that or when I didn't work on that.

Q. Well, Group A shows all of the patents and applications for patents? A. Yes.

Q. On November 14, 1933, according to this Exhibit, there was a patent application filed and another on September 4, 1935. Wouldn't that indicate that you were working on these patents or on that maybe as late as 1935?

A. Yes, it would.

Mr. Altman: Your Honor, just to clarify this for the record, sometime earlier in this cross-examination Mr. Harvey referred to the work he did in the early years in 1927 and earlier, and in that connection he referred to a patent issued in December 1927. I just want to point out for the record that

(Testimony of Leo M. Harvey.)

that is the same patent to which he is now referring, which is in Group A of Exhibit No. 1.

Q. (By Mr. Tonjes): Is that the same patent, Mr. Harvey?

A. That is right. It is in here 1927. [114]

Mr. Altman: And I think it is a round wire patent.

The Witness: A round wire patent. You see this is an issue in a foreign country. The date of the American patent for it would be much later time in the United States. I don't know just exactly which one this is.

Q. (By Mr. Tonjes): Did you assign that to the Gerrard Company, the right to operate under that to the Gerrard Company? A. Yes.

Q. What consideration did you receive for that?

A. I forget. There was some Gerrard money used, and he said he would like to have it, and we had done business with him and I says O.K. we will give it to you, because we had done some machine work for him, which was our business. In other words, they made the machines and they wanted the patent. I says, O. K. you can have it. I don't remember exactly what the payment was. If it was made it was very nominal, because it was a question of our building; about the cost of the application.

Q. You sold all of your round wire tying devices when you entered into this transaction in 1938, is that correct? A. Yes, yes.

Q. Have you devoted any time to developing any round wire devices after that date? A. No.

(Testimony of Leo M. Harvey.)

Q. When did you first start to work on a flat wire tying device?

A. My recollection is some time in 1927, 1927 or 1928, just about.

Q. Do you recall when you got your first patent for a flat wire tying machine?

A. No, but I can identify it if I look at this agreement here.

Q. All right, look over that if that would help you.

A. Well, here is one on July 17, 1928, looks like the earliest. [116]

Q. And when did you first give someone a right to operate under this patent, under a royalty arrangement?

A. I believe that was given to the predecessor of the Gerrard Company, who called themselves the Tying Machines Company, and then the Garrard Company bought them out, so the agreement was finally worked out, and we had received a royalty of \$15,000.00 on the foreign flat-band patent, and \$15,000.00 a year for the domestic.

Q. Was that before or after they had the right to operate under the round wire device patent?

A. After that.

Q. Now, I am not talking about the wire patents. I am talking about the other patent devices that you have. Did you sell any of those? A. No.

Q. You developed some washing machine patents, did you not?

A. Yes, but I didn't sell them.

(Testimony of Leo M. Harvey.)

Q. What did you do with them? Did you sell them out? A. No.

Q. You still own them? A. Yes.

Q. Do you get any royalties from them?

A. No.

Q. Did you ever get any patents on the food cutting device? [117]

A. I told you we got a patent on a clipper for cutting oranges.

Q. Do you still own that?

A. Well, that patent expired years ago.

Q. You also got a patent on some paper towel dispensers? A. Right.

Q. Do you still own that? A. Yes.

Q. Did you give anyone a right to operate under that?

A. Yes. The concern that operates under those patents owns them. The title is really in that company.

Q. You mean you transferred those patents to that corporation? What is the name of it?

A. Harcraft Company.

Q. What did you do, transfer the shares of stock?

A. I don't know exactly how it was. I don't remember. I didn't get any money, and I don't remember how it was.

Q. Well, in any event, you transferred the patents to that corporation? A. That is right.

Q. And in all probability, you got a consideration of them, you would not transfer the patents if

(Testimony of Leo M. Harvey.)

you didn't either get some stock or something for it? [118]

A. That is right, yes, sir.

Q. Did you ever transfer any other patent?

A. Well, that is pretty hard for me to answer. You see, it goes back over a long period of time, and I can't give you a reasonable answer.

Q. Now, you stated that you paid Lawrence Harvey a sum of money out of each of these \$40,000.00 payments you received. A. Yes, sir.

Q. How much did you pay him, do you recall?

A. \$8,000.00, that was the 20 per cent arrangement, the arrangement was for him to have 20 per cent of the \$40,000.00, whenever I would get it I would pay him \$8,000.00 per year.

Q. Did you pay him any cash pursuant to the agreement made in April of 1938?

A. I don't remember the date of the agreement. I don't remember at this time.

Q. That is Mr. Lawrence Harvey, is he your son? A. Yes, sir.

Q. How old was he in 1938?

A. Let me figure it out. He was about 28, or something like that.

Q. Was there ever any agreement between you and him prior to the date of the sale, that he would have any interest in the patent? [119]

A. Yes, provided he makes the deal, that he must come out to make the deal with the American Wire and Steel Company, and the U. S. Steel Com-

(Testimony of Leo M. Harvey.)

pany; if he is to make the deal he will get it, whatever I received he will get a percentage from.

Q. Was the agreement in writing?

A. No, nothing reduced to writing, but we just had—a contract was signed up after that to reduce it to writing.

Q. Did you have any other attorney working with you in connection with this deal?

A. Yes, we did. We had the tax attorney working with the deal.

Q. What was his name?

A. Max Schlesinger.

Q. Max Schlesinger, tax accountant? Do you know what amount he got?

A. That I don't remember.

Q. Did you also employ an attorney?

A. Some other member by the name of Rubin, as I recollect.

Q. Did you employ Walter Sheldon?

A. Yes.

Q. In 1938? A. Yes.

Q. Do you know what his connection was with the deal, [120] if any?

A. He advised how to handle it.

Q. Do you remember what you paid him?

A. No, I don't remember.

Q. Does the figure of approximately \$11,000.00 sound familiar at all?

A. Well, I don't know. I can't answer that.

Q. Do you have your records here so you could

(Testimony of Leo M. Harvey.)

make reference to them and ascertain what you paid him? A. No, I have no records.

Q. Mr. Harvey, you also, I believe, stated that it was your opinion that these round wire patents had no value, or a very small value, what was it you said?

A. Well, I didn't say no value. I said that they are no great intrinsic value, because you got to understand what a patent is, and a patent is not, so far as is it a patent, or what the patent consists of, and some patents are only improvements on a principle which is already in existence. Those patents are not of much value, because they are not basic patents.

Q. As I recall, you referred in your cross-examination to basic patents, and you stated one of the differences was that if there should be some conflict between the operation under your flat wire tying device, and the round wire, did you mean by that?

A. No, sir, there is not. That is an entirely different thing.

Q. Is the flat wire used to hold a box?

A. Really they both work an iron band around there, and it is a very easy matter to make a seal to hold it—can I change my—

Q. Sure. You go right ahead and explain the difference in the two.

A. The object of this round wire and flat wire is the same, is to hold the box together, but the most distinctive feature between the two is to create a seal to hold it together so it won't come apart. On

(Testimony of Leo M. Harvey.)

the round wire to make a seal is very easy, there isn't anything to it, it is just twisted. That is why people can all get in the round wire business, but it is different in the flat band. People who are in the flat business don't nail off the wire.

Q. You stated, I believe, in your direct examination that the Gerrard Company took care of certain patents, the expenses? A. Yes, sir.

Q. Will you state to the Court what patents they were related to?

A. They related to the foreign patents. All the expenses of filing applications for the foreign patents, they paid them. [122]

The Court: In other words, you obtained the basic patents, and they obtained the foreign patents, is that the idea?

The Witness: Yes. I paid all of the money to create the patents, and they took out the same patents in foreign countries.

Q. (By Mr. Tonjes): Were you familiar with the phraseology in this contract of March 21, 1938?

A. I am.

Q. I ask you to take a look at page 4 of that contract, where it has a reference to—about the middle of the second paragraph there, applications and inventions, do you remember that portion of it?

A. Yes, I do.

Q. Do you know what prompted the insertion of that in that?

A. Well, you see, they didn't know, they didn't want to go to the trouble to examine the records,

(Testimony of Leo M. Harvey.)

so I volunteered to repay them, under that particular paragraph.

Q. Can you recollect any expenses under that particular paragraph which might have been given back?

A. I don't recall. There is nothing here that I remember.

Q. I wish you would try to recollect, Mr. Harvey, the [123] nature of the services performed for you by Walter Sheldon, and approximately the fee paid to him.

A. I can look it up in the records, and I can bring it in to you. I wouldn't want to hazard a guess now to make a misstatement of facts.

Q. Did Lawrence Harvey do any work in promoting this sale, for instance, did he act as a salesman, or contact man, or something of that sort?

A. Well, I don't know what you would call it.

Q. Just what did he do?

A. Oh, he talked to the people in the different businesses, he knows his business the same as I do mine. He had to watch the deal, because we were doing business with strangers. I don't believe there was any question but what he tended to his work.

Q. Well, you must have had some general fee in mind, as to how much he would get paid for it, isn't that right?

A. Yes.

Q. It is usual amongst lawyers to find out, in any event, and I imagine you gave him some definite instructions. What did you tell him to do?

A. To make a deal.

(Testimony of Leo M. Harvey.)

Q. In his capacity as a lawyer, to draw the contract?

A. No, in his capacity as a lawyer to help decide things. He is supposed to be a graduate in business administration. [124]

Q. Does he know all about the patent?

A. Yes, he knows about the patent, but I didn't use him as a patent attorney.

Q. Did he ever represent you in any business negotiations before that? A. Yes, he did.

Q. Did he represent you when you were selling patents?

A. No, I wouldn't say that, because we had Mr. Sheldon representing us.

Q. What was the nature of the service that he performed for you?

A. Well, he negotiated with people.

Mr. Tonjes: This is off the record.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

Mr. Altman: We will stipulate that Mr. Leo M. Harvey in 1938 paid to Mr. Walter Sheldon \$22,500.00, that he deducted the said sum on his income tax return for that year; that it represents legal fees paid to Walter Sheldon, an attorney in San Francisco, for his services, including the protection of a manufacturer's license agreement which had been granted to the Gerrard Company, a corporation, by Mr. Leo M. Harvey, who was the sole owner of said patent. [125]

(Testimony of Leo M. Harvey.)

Mr. Tonjes: All right.

Mr. Altman: The parties stipuate to that.

Q. (By Mr. Tonjes): Mr. Harvey, I believe you stated that during the various years from 1932 until you sold the patents in 1938, you received minimum royalties of \$30,000.00 a year?

A. Right.

Q. And you reported that on your income tax returns for those years? A. I believe I did.

Q. Could you tell me where that is reflected in your return, that is, your return for 1937?

A. I am not prepared to answer that, because I very seldom read those returns, and I don't very well understand them. I want to answer the truth.

Mr. Tonjes: Yes, we appreciate that, Mr. Harvey. If your Honor please, respondent offers in evidence the return identified by the petitioner as being his income tax report for the year 1937. Incidentally, I will say this is not a return for any of the years before the Tax Court in this proceeding, but respondent offers it for the purpose of showing that the petitioner reported the \$30,000.00 which he received as royalty in the manner set forth in the return.

The Court: Any objection?

Mr. Altman: Could the reporter read that back, please?

(The remark was read.) [126]

Mr. Altman: No objection, your Honor.

The Court: It is admitted, Respondent's Exhibit

A. Do you want to substitute a photostatic copy?

(Testimony of Leo M. Harvey.)

(The document above referred to was received in evidence and marked Respondent's Exhibit A.) [127]

* * * * *

Q. (By Mr. Tonjes): Mr. Harvey, I believe you testified that the amounts of royalties received by you were all accounted for on your books or in your income tax returns?

A. I believe they were.

Q. When did you first start receiving that royalty of a \$30,000.00 minimum?

A. Sometime in 1930, if I recollect correctly.

Q. 1930? A. Yes, sir, 1930 or 1931.

Q. And did that income come to you from a contract with the Gerrard Company?

A. That is right.

Q. Did you have a written contract covering the license agreement? A. Yes, I did. [128]

Q. Do you have a copy of that here?

A. I don't think I have it with me.

Q. Did you have more than one contract covering those items?

A. Yes, we had two contracts, one covering the foreign flat band, and one covering what we called the domestic flat band.

Q. All for the flat band?

A. That is right.

Q. No contract covering the round band?

A. Yes, we had a contract, but it was not any royalty contract.

(Testimony of Leo M. Harvey.)

Q. What was the nature of the contract?

A. Which one?

Q. The one related to the round wire.

A. Manufacturing the articles for them.

Q. And that was with the Gerrard Company too?

A. Yes.

Q. Were they entered into at or about the same time?

A. No, before that.

Q. Which one was entered into first?

A. The round wire.

Q. Now, I show you your income tax return for 1931, Mr. Harvey, and ask you if you can state whether, in your best judgment, the royalty income is reported on that return? [129]

A. I believe I already told you, when you asked me about the other one, that I did not make out those income tax returns, I could not very well state. In the majority of cases I signed them, and I am ashamed to admit I didn't even read them.

Q. Yes, but you kept books, I presume, or books were kept for you?

A. Yes, sir.

Q. And those books, to the best of your knowledge, reflect the receipt of all the income you received?

A. I believe it did.

Q. And in all probability those returns are made up from the books, is that correct?

A. I believe that was the case.

Q. That would be the normal course of events, I believe, and I presume that happened in your case. Would you say that was true?

A. I think so.

Q. I notice on this return, Mr. Harvey, that you

(Testimony of Leo M. Harvey.)

state that your occupation is proprietor of machine shop, and inventor. A. Yes, sir.

Q. Could you explain how the designation of your business as an inventor appeared on that return?

A. I don't know. I couldn't answer you, because, as [130] I told you, I very seldom read the returns, and I don't know why it is marked inventor, or proprietor of machine shop.

Q. You employed someone to make up your returns, didn't you? A. I did.

Q. You have no reason to believe that anything in this return is inaccurate, have you?

A. I have no reason to believe at all. I don't know.

Mr. Tonjes: The respondent offers the return as identified in evidence. [131]

* * * * * * *

Mr. Altman: I have no objection to the introduction of those returns.

The Court: Admitted, Respondent's Exhibit B.

(The document above referred to was received in evidence and marked Respondent's Exhibit B.)

Q. (By Mr. Tonjes): Would you say also, Mr. Harvey, to the best of your knowledge and belief, that income from royalties is properly reflected in your return for 1932? A. 1932?

Q. That is the return I am just presenting to you.

(Testimony of Leo M. Harvey.)

A. This one here. This is marked "Machine Shop," it is not marked inventor here. Has that anything to do with it?

Q. No, I am just asking you whether or not——

A. That is my signature. I signed it.

Q. And you believe that the income that you got from the royalties is shown in there in some way or other?

A. I believe so, yes.

Mr. Tonjes: Respondent offers the return for 1932 in evidence, your Honor.

The Court: Admitted, Respondent's Exhibit C.

(The document above referred to was received in evidence and marked Respondent's Exhibit C.)

Mr. Tonjes: And would you say the same for 1933?

The Witness: That is my signature. [132]

Q. (By Mr. Tonjes): Would you say that to your best knowledge and belief——

A. This is my signature. I signed it.

Q. Would you say that to the best of your knowledge and belief the \$30,000.00 is properly accounted for in this return?

A. Yes, I think so.

Mr. Tonjes: Respondent offers the return for 1933 in evidence.

The Court: Admitted, Respondent's Exhibit D.

(The document above referred to was received in evidence and marked Respondent's Exhibit D.)

(Testimony of Leo M. Harvey.)

Q. (By Mr. Tonjes): I now show you a return for 1934, Mr. Harvey, and ask you, to the best of your knowledge, whether the \$30,000.00 minimum royalty received from the wire patents is accounted for in the return?

A. This is my signature, and I signed it. I presume the same answer would be that I made to the other.

Mr. Tonjes: Respondent offers the return for 1934 in evidence.

The Court: Admitted, Respondent's Exhibit E.

(The document above referred to was received in evidence and marked Respondent's Exhibit E.) [133]

Q. (By Mr. Tonjes): Would you say the same for 1935, Mr. Harvey?

A. That is my signature, and that is the same answer as I made to the other one.

Q. Your answer would be the same?

A. Yes.

Mr. Tonjes: Respondent offers in evidence the return for 1935.

The Court: Admitted, Respondent's Exhibit F.

(The document above referred to was received in evidence and marked Respondent's Exhibit F.)

Q. (By Mr. Tonjes): Will you say the same for 1936?

A. This is my signature, and the same as for 1936.

(Testimony of Leo M. Harvey.)

Mr. Tonjes: Respondent offers the return for 1936.

The Court: Admitted, Respondent's Exhibit G.

(The document above referred to was received in evidence and marked Respondent's Exhibit G.)

Mr. Altman: Your Honor, I wonder if the record may show that by failing to object to the introduction of these returns, I am not in any way agreeing to their materiality.

The Court: The record may show that if you desire it.

Mr. Tonjes: If your Honor please, 1938 is the year [134] in which the transaction took place which we have in controversy, and whether or not the income arising from this sale is reportable on the installment basis; I think it might be helpful to the Court to put this return in evidence, in order to show how the transaction was handled, and then I expect to offer the returns for 1939, 1940 and 1941, which are the taxable years in controversy, and in view of the fact that royalty payments for the years prior to 1938 are in evidence, it may just complete the record, although I do not think it is too important. With that statement I offer the return of the petitioner for the year 1938.

Mr. Altman: No objection.

The Court: Admitted, as Respondent's Exhibit H.

(Testimony of Leo M. Harvey.)

(The document above referred to was received in evidence and marked Respondent's Exhibit H.)

Mr. Tonjes: I may add that there is an original and amended return there, your Honor, which I would like to have as one exhibit.

The Court: One exhibit, all right.

Mr. Tonjes: Now, I will offer the return of Mr. Leo M. Harvey, the petitioner in this case, for the year 1939, being one of the years here in controversy.

The Court: Admitted, as Respondent's Exhibit I.

(The document above referred to was received in evidence and marked Respondent's Exhibit I.) [135]

Mr. Tonjes: I make the same offer for the year 1940.

The Court: Admitted, Respondent's Exhibit J.

(The document above referred to was received in evidence and marked Respondent's Exhibit J.)

Mr. Tonjes: And the same offer for the year 1941.

The Court: Admitted, Respondent's Exhibit K.

(The document above referred to was received in evidence and marked Respondent's Exhibit K.)

* * * * *

(Testimony of Leo M. Harvey.)

Q. (By Mr. Tonjes): Mr. Harvey, I show you what purports to be your income tax return for the year 1938, and ask you if you can identify the signature appearing thereon as your signature?

A. Yes, I did. That is my signature.

Q. I now show you what purports to be the income tax return of Leo M. Harvey, and ask you if that is your signature?

The Court: What year is that?

Mr. Tonjes: 1939. [136]

Q. (By Mr. Tonjes): Whether that is your signature, and that is your tax return?

A. That is my signature.

Q. I now show you what purports to be an individual income tax return for the year 1940 of Leo M. Harvey, and ask you if that is your signature on that document?

A. Yes, sir, this is my signature.

Q. Now I show you what purports to be the income tax return of Leo M. Harvey for the year 1941, and ask you if that is your signature appearing thereon?

A. That is my signature. [137]

* * * * *

Redirect Examination

By Mr. Altman:

Q. Mr. Harvey, you were asked on cross-examination whether you had transferred patents to the Harcraft Company, and you answered that you did. Did you receive any consideration of any kind for that transfer?

A. None.

(Testimony of Leo M. Harvey.)

Q. How much stock do you own in the Harcraft Company? A. About 50 per cent.

The Court: Well, these patents were not paid for in stock?

The Witness: No, your Honor.

Q. (By Mr. Altman): Mr. Harvey, on the direct examination you made some statement in connection with the transaction represented by [138] Exhibit 1, that is the sale to Gerrard in 1938. Did you receive some advice in connection with the income tax—what, if any, income tax problem was that?

A. The income tax problem involved at that time was whether the money that I would receive from the Gerrard Company for the sale of those patents would be ordinary income or a capital gain, and then in discussing the matter with an attorney by the name of Bye, for the Steel Company, he says, "The best thing for you to do is take the question up in Washington direct with the Treasury Department, present your case and show them the contract, and get their final word on it, and I believe it is positive that it will be construed as capital gain."

Q. Did this income tax conversation have to do with your income tax, with your contract with Lawrence Harvey? I mean the contract under which you were to pay Lawrence Harvey 20 per cent.

A. Well, indirectly it did, because it was my understanding that the money Lawrence will re-

(Testimony of Leo M. Harvey.)

ceive should be ordinary income, while the money I would get was a capital gain.

Q. Well, did you expect to save any income tax by paying Lawrence these amounts?

A. No, no, because I figured that he would lose money by doing it, because his, as a capital gain it would be in a [139] smaller bracket.

Mr. Altman: If your Honor please, counsel and I have agreed upon a computation in that respect, showing exactly what the difference was involved, and showing that the taxes paid on Lawrence Harvey's return were much greater than the reduction in taxes in Mr. Leo M. Harvey's return, and I should like to offer that in evidence as Petitioner's Exhibit 2.

Mr. Tonjes: That is objected to.

The Court: If it is stipulated, why make it an exhibit?

Mr. Tonjes: It is not stipulated, your Honor. We were asked to stipulate, but I did not put the document in the form of a stipulation because I want to object to it, on the ground it is wholly immaterial what the tax effect would have been had Mr. Harvey done this, that or the other thing. As I see it, it is entirely immaterial. It certainly does not in any way give Mr. Lawrence Harvey or Mr. Leo Harvey, or anybody else, any rights in any of these patents, and what the tax effect would have been had the transaction, or any part of it, taken a different form, as I say, is entirely immaterial.

The Court: To what extent is that material?

(Testimony of Leo M. Harvey.)

Mr. Altman: It goes, if the Court please, to the agreement between Mr. Leo Harvey and his son, Lawrence Harvey, [140] with respect to this service.

The Court: You make an objection as to the materiality. Are you agreeing in any respect whatever as to this document he is offering in evidence?

Mr. Tonjes: Yes, I agree, your Honor, that the figures shown thereon are correct.

The Court: Very well, it may be admitted as Petitioner's Exhibit No. 2, simply for the purpose of showing that fact.

(The document above referred to was received in evidence and marked Petitioner's Exhibit No. 2.)

Q. (By Mr. Altman): Mr. Harvey, in the course of this examination you made a statement that your contract with Lawrence Harvey was reduced to writing after the transaction with Gerrard. I show you a copy taken from my own file of what purports to be your agreement. Will you say whether this is a true copy of that agreement?

A. I believe it is. This is a true copy of the agreement that I made with Lawrence on April 2, 1938.

Mr. Altman: I should like to offer that as Petitioner's Exhibit 3.

Mr. Tonjes: No objection.

The Court: Admitted.

(The document above referred to was received in evidence and marked Petitioner's Exhibit No. 3.) [141]

PETITIONER'S EXHIBIT No. 1

* * * * *

It is understood and agreed that the aforesaid U. S. patents, U. S. patent applications and inventions in the round wire and flat band strapping fields only and the aforesaid foreign patents, foreign patent applications and inventions in the flat band strapping field only hereinabove referred to as being owned by first party and limited as aforesaid include not only patents, patent applications and inventions owned by first party, but also patents, patent applications and inventions, if any, owned by Herbert Harvey and in which either or both first party and said Herbert Harvey have an interest, and first party agrees that with respect to all said patents, patent applications and inventions, if any, owned by or in which Herbert Harvey has an interest, first party will cause said Herbert Harvey to execute and deliver all instruments and to do all acts and things which first party has herein agreed to execute and deliver and do with respect to patents, patent applications and inventions owned by first party.

* * * * *

[Endorsed]: Admitted in evidence Nov. 8, 1946.

PETITIONER'S EXHIBIT NO. 2

If (1) the payments by petitioner Leo M. Harvey to Lawrence A. Harvey referred to in paragraph 5-C-1 of the petition were eliminated from the gross income of said Lawrence A. Harvey, and (2) a like amount was restored to the net income of petitioners Leo M. Harvey and Lena P. Harvey, and (3) the gains derived from the sale of patents referred to in paragraph 5-A-1 of the petition were treated as capital gains, and (4) the said capital gains were divided between short term and long term on the basis of the same percentages as those used by the petitioners on their returns (7.292% to assets held eighteen months or less and 92.708% to assets held more than twenty-four months), then

The resulting aggregate additional tax for each year of Leo M. Harvey and Lena P. Harvey, the resulting reduction in tax for each year of Lawrence A. Harvey, and the net resulting reduction in the aggregate taxes of Leo M. Harvey, Lena P. Harvey and Lawrence A. Harvey for each year would be as follows:

Year	Additional Tax Leo M. & Lena P. Harvey	Reduction in Tax— Lawrence A. Harvey	Net Reduction in Tax— Leo M. Harvey, Lena P. Harvey and Lawrence A. Harvey
1938.....	\$ 469.42	\$1,128.13	\$ 658.71
1939.....	692.60	657.64	(34.96)
1940.....	1,422.68	2,017.31	594.63
1941.....	1,492.00	4,340.80	2,848.80
	<hr/>	<hr/>	<hr/>
Total	\$4,076.70	\$8,143.88	\$4,067.18

[Endorsed]: Filed Nov. 8, 1946. [143]

PETITIONER'S EXHIBIT NO. 3

Lawrence A. Harvey
Attorney and Counselor at Law
6200 Avalon Boulevard
Los Angeles, California

April 2, 1938.

To Leo M. Harvey, dr.

For good and valuable services in aiding and assisting in the negotiation and the drafting and preparation of contracts and notes in connection with the sale of the Gerrard patents and agreements on wire tying business to The Gerrard Company, Inc. and the American Steel & Wire Company, you are to pay me Twenty (20%) Per Cent of all proceeds of such sale as received by you.

Your signature will constitute your agreement.

/s/ LAWRENCE A. HARVEY.

I hereby agree to the above

/s/ LEO M. HARVEY.

[Pencil Notation]: Patent.

[Endorsed]: Filed Nov. 8, 1946. [144]

The Tax Court of the United States
Dockets No. 7116 and 7117

LEO M. HARVEY and LENA P. HARVEY,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DESIGNATION OF CONTENTS OF RECORD
ON REVIEW

To the Clerk of the Tax Court of the United States:

You will please prepare, transmit, and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit copies (or originals where indicated) duly certified as correct of the following documents and records in the above-entitled causes in connection with the petition for review heretofore filed by the petitioners:

1. The docket entries of all proceedings before the Tax Court.

2. Pleadings before the Tax Court, as follows:

- (a) Petition (in Docket No. 7116 only).
- (b) Answer (in Docket No. 7116 only).
- (c) Amendment of petitions embodied in motion to amend them, filed September 6, 1946, and granted October 9, 1946.
- (d) Amendment of petitions embodied in motion to amend them, filed and granted November 4, 1946.

- (e) Answer to petition as amended, filed November 8, 1946.
- (f) Answer to amendment to petition, filed November 8, 1946.

3. Motion for Judgment on the Pleadings, filed April 2, 1945, and denied May 17, 1945 (in Docket No. 7116 only). [147]

4. The findings of fact and opinion of the Tax Court.

5. Motion for rehearing.

6. Order entered April 29, 1947, amending findings of fact and opinion and denying motion for rehearing.

7. The decisions of the Tax Court.

8. The petition for review.

9. All of the official transcript of oral testimony of the hearing November 8, 1946.

10. All of the exhibits, including copies of petitioners' exhibits 2 and 3, and the originals of all the other exhibits.

11. This designation of contents of record on review.

The pleadings and other papers filed separately in Docket No. 7117 are omitted for the reason that they are identical in all material respects, except as to name of petitioner, with corresponding pleadings and other papers in Docket No. 7116. Inclusion of the pleadings or other papers in Docket No. 7117 would in consequence constitute mere duplication.

With respect to items 9 and 10 above petitioners

quote as follows from a letter received from respondent dated October 31, 1947:

“If you do not wish to go up on the pleadings and the memorandum findings of fact and opinion and decisions of the Tax Court, it would seem, in view of the nature of the questions involved, that a complete record is necessary and that in your designation of contents of record on review you should therefore also call for the transcript of the hearing and the exhibits.”

Dated: November 20, 1947.

/s/ GEORGE T. ALTMAN,
Attorney for Petitioners.

Personal service of a copy of the foregoing designation is hereby acknowledged as having been made this 24th day of November, 1947.

/s/ CHARLES OLIPHANT, CAR
Chief Counsel, Bureau of
Internal Revenue.

Filed November 25th, 1947. [149]

[Title of Tax Court and Causes.]

CERTIFICATE

I, Victor S. Mersch, clerk of The Tax Court of the United States, do hereby certify that the foregoing pages, 1 to 149, inclusive, contain and are a true copy of the transcript of record, papers, and

proceedings on file and of record in my office as called for by the Praeceptum in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 15th day of December, 1947.

EMJ

[Seal] /s/ VICTOR S. MERSCH,
Clerk, The Tax Court of the
United States.

[Endorsed]: No. 11823. United States Circuit Court of Appeals for the Ninth Circuit. Leo M. Harvey and Lena P. Harvey, Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed January 2, 1948.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals
for the Ninth Circuit

11823

T. C. Docket Nos. 7116 and 7117

LEO M. HARVEY and LENA P. HARVEY,
Petitioners on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

MOTION FOR ENLARGEMENT OF TIME IN
WHICH TO FILE TRANSCRIPT OF
RECORD

Come Now the petitioners in the above-entitled proceeding, by their counsel of record, and request an enlargement of 40 days in which to file the Transcript of Record. The reason for the enlargement is that the time otherwise allowable would expire November 26, 1947, and the time so far elapsed has been lost in an attempt, which has not proved successful, to reach an agreed statement under Rule 76 of the Rules of Civil Procedure.

Respondent has stated that he will have no objection to the granting of this motion.

Wherefore, it is prayed that this motion be granted.

/s/ GEORGE T. ALTMAN,
Attorney for Petitioners on
Review.

State of California,
County of Los Angeles—ss.

George T. Altman, being duly sworn, deposes and says: that he is attorney for petitioners on review in the above-entitled matter; and that the facts stated in the foregoing motion are true and correct.

/s/ GEORGE T. ALTMAN.

Sworn and subscribed to before me this 14th day of November, 1947.

/s/ BEN H. RUDNICK,

Notary Public in and for Said
County and State.

[Endorsed]: Filed Nov. 18, 1947; re-filed Jan. 2, 1948.

So Ordered:

/s/ FRANCIS A. GARRECHT,

Senior United States Circuit
Judge.

In the United States Circuit Court of Appeals
for the Ninth Circuit

Docket No. 11823

LEO M. HARVEY and LENA P. HARVEY,
Petitioners on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

STATEMENT OF POINTS ON WHICH
PETITIONERS INTEND TO RELY

Come Now the petitioners in the above-entitled proceeding, by their counsel of record, and, for the purpose of statement of points on which they intend to rely, assign as error the following acts or admissions of the Tax Court:

1. Denial of motion for judgment on the pleadings.
2. Failure to hold that the amount, or any portion of the amount, received each year on the Gerrard notes was an amount received on the sale of "capital assets" as that term is defined in Section 117(a)(1) of the Internal Revenue Code.
3. Failure to find that the flat band patents sold to Gerrard were not property used in the trade or business of a character which is subject to the allowance for depreciation.

4. Failure to allow either as offsets or deductions the amounts paid Lawrence A. Harvey and Herbert Harvey, or any portion thereof.

5. Finding of deficiencies for the years involved instead of overpayments as requested.

/s/ GEORGE T. ALTMAN,

Counsel for Petitioners on
Review.

Dated: January 7, 1948.

[Endorsed]: Filed Jan. 8, 1948.

